BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD

In the Matter of Department of Enforcement, Complainant, vs. Scott E.Wiard Ypsilanti, MI, and James D. Reisinger Dexter, MI, Respondents.	DECISION Complaint No. C8A030078 Dated: October 18, 2005

Respondents made unauthorized investments of customer funds and recommended unsuitable securities transactions to their customers. Respondent Wiard also maintained discretionary accounts when NASD had prohibited him from handling such accounts, and failed to disclose customer complaints on his Form U4. Held, findings modified and sanctions affirmed.

Appearances

For the Complainant: Kevin G. Kulling, Esq., NASD Department of Enforcement

For the Respondents: Edmund J. Sikorski, Jr., Esq.

DECISION

Pursuant to NASD Procedural Rule 9311, Scott E. Wiard ("Wiard") and James D. Reisinger ("Reisinger") appeal a May 25, 2004 Hearing Panel decision. The Hearing Panel concluded that the respondents engaged in unauthorized trading. The Hearing Panel also found that respondents made unsuitable recommendations to their customers in violation of NASD Conduct Rule 2110. The Hearing Panel barred the respondents for these violations. Finally, the Hearing Panel found that Wiard violated conditions that NASD imposed upon him when it approved his sponsoring firm's Membership Continuance Application ("MC-400 Application"), and that Wiard also failed to disclose customer complaints on his Uniform Application for

Securities Industry Registration ("Form U4").[1] After a thorough review of the record, we uphold the Hearing Panel's findings, except we find that respondents made unsuitable recommendations in violation of NASD Conduct Rule 2310, rather than Conduct Rule 2110. In addition, we affirm the bars imposed upon the respondents.

I. Background

Wiard entered the securities industry in 1986. In November 1989, he became associated with NASD member Royal Alliance Associates, Inc. ("Royal Alliance") as both a general securities representative and a general securities principal. On May 23, 2000, Royal Alliance filed an MC-400 Application with NASD to permit Wiard to continue his association with that firm. On December 15, 2000, we approved Royal Alliance's application. As a condition of the approval, however, we prohibited Wiard from maintaining any discretionary accounts. Wiard is not registered currently with any NASD member.

Reisinger entered the securities industry in 1987. Reisinger also became associated with Royal Alliance in November 1989 as a general securities representative and a general securities principal. Reisinger is not registered currently with any NASD member.

In addition to their association with Royal Alliance, Wiard and Reisinger owned and operated Horizons Planning Corporation ("Horizons Corp.") during the period at issue. Horizons Corp. was an investment advisor registered with the state of Michigan.

II. Procedural History

NASD's Department of Enforcement ("Enforcement") filed a complaint on October 13, 2003, alleging that the respondents violated NASD Conduct Rule 2110 by using their customers' funds to execute an unauthorized investment strategy. The complaint further alleged that the respondents violated NASD Conduct Rules 2110 and 2310 because these unauthorized investments were also unsuitable for their customers.[2] In addition, the complaint stated that Wiard violated NASD Conduct Rule 2110 by maintaining discretionary accounts, which was prohibited under the conditions NASD imposed on him when it approved his sponsoring firm's MC-400 Application.[3] Finally, the complaint alleged that Wiard violated NASD Conduct Rule 2110 by failing to update his Form U4 to disclose two customer complaints.

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[1] In light of the bar, no additional sanctions were imposed upon Wiard for these violations.

[2] The complaint also alleged that respondents violated IM-2310-2, which imposes a fundamental responsibility for fair dealing with customers on all members and registered representatives. NASD Conduct Rule 2310, commonly referred to as the "suitability" rule, is grounded in this fundamental responsibility. *See John M. Reynolds*, 50 S.E.C. 805, 809 n.13 (1991).

[3] Wiard became subject to a statutory disqualification in April 1999. On May 23, 2000, Royal Alliance filed an MC-400 Application to permit Wiard to continue his association with the

[Footnote continued on next page]

Respondents filed an answer contesting the charges and requested a hearing. A hearing was held on March 23 and 24, 2004, and the Hearing Panel issued its decision on May 25, 2004. This appeal followed.

III. Facts

From 1989 to 2002, respondents were associated with Royal Alliance and were registered as both general securities principals and general securities representatives. At the same time, respondents owned and operated Horizons Corp. The respondents' Horizons Corp. customers were also Royal Alliance customers.

For the majority of their Horizons Corp. customers, respondents recommended and implemented a market-timing investment strategy they referred to as the Strategic Journal Transfers ("SJT") program. The SJT strategy was to hold customers' investments in money market funds during most of each month, but to transfer the customers' entire investments into high-risk equity funds for a fairly brief time period around the end of the month.[4]

When the customers were invested in the equity funds, respondents sought to purchase highly volatile funds for the SJT program, on the theory that, because the customers were invested in equity funds for only a brief, favorable period each month, high volatility was likely to maximize the customers' return on their investments. Respondents advised their customers that under the SJT program, investing their funds in money markets for most of each month and transferring these funds to volatile equity funds for only relatively short periods at the end of each month would expose the customers to only moderate overall risk. The respondents never told their customers that they would invest the SJT funds in high-risk securities over the long

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firm. On December 15, 2000, NASD approved this application under the condition, among others, that Wiard not be allowed to maintain any discretionary accounts. In April 2002, Wiard voluntarily terminated his association with Royal Alliance. In August 2003, another firm, Prestwick Securities, Inc. submitted an MC-400 Application to permit Wiard to associate with it. On February 5, 2004, NASD denied this application and Wiard appealed this denial to the Commission. On appeal, the Commission affirmed NASD's denial, finding that Wiard managed discretionary accounts in violation of the conditions NASD had imposed when it approved Royal Alliance's MC-400 Application. *See Scott E. Wiard*, Exchange Act Rel. No. 50393, 2004 SEC LEXIS 2112, at *8 (Sept. 16, 2004).

[4] The SJT program rested upon respondents' theory that, because corporate retirement plans generally make large investments on behalf of their employees at the end of each month, the period around month's end is the optimal, least risky time to be invested in equity funds. To enter the SJT program, respondents' customers gave Horizons Corp. a written Authorization for Discretionary Accounts Form to manage their investments. In addition, they opened accounts with Royal Alliance.

term. Respondents, however, claim that market conditions forced them to recommend a long-term investment of the SJT funds in high-risk securities.

Respondents started the SJT program in approximately October of 1987. According to the respondents, the SJT program did not produce any losses for their customers until September 2000, when the market entered a steep decline. On September 30, 2000, respondents moved all of their SJT customers' funds from money market funds to equity funds, in accordance with the initial SJT strategy. In an attempt to recapture the losses stemming from the market decline, respondents did not move their customers who had experienced these losses back into money market funds in early October, or at any time thereafter. Instead, from September 30, 2000, to the date of the hearing, the respondents left these SJT customers' funds fully invested in volatile securities. The respondents did not advise the customers that their funds would not be moved back into the less risky money market funds in accordance with the SJT program's initial market-timing strategy.

IV. Discussion

The material facts in this case are undisputed. After reviewing the record in this matter, we affirm the Hearing Panel's findings as to respondents' unauthorized trading in violation of Conduct Rule 2110. We reverse, however, the Hearing Panel's findings that: (1) the respondents did not violate the suitability rule, Conduct Rule 2310; and (2) the respondents' unsuitable recommendations were an independent violation of Conduct Rule 2110's ethical requirements. We affirm the Hearing Panel's findings that Wiard violated conditions imposed upon him when NASD approved his continued association with Royal Alliance and failed to amend his Form U4 to disclose certain customer complaints, both in violation of Conduct Rule 2110. Finally, we affirm the Hearing Panel's decision to bar the respondents.

A. The Respondents Engaged in Unauthorized Trading by Failing to Follow Their Customers' Instructions Regarding Risk

NASD Conduct Rule 2110 requires that a member "shall observe high standards of commercial honor and just and equitable principles of trade."[5] Unauthorized trading in a customer's account violates NASD Conduct Rule 2110. *See Jeffrey B. Hodde*, Complaint No. C10010005, 2002 NASD Discip. LEXIS 4, at *13 (NAC Mar. 27, 2002). The predecessor to the NAC has previously held that a respondent engages in unauthorized trading when he fails to: (1) follow a customer's instructions regarding the level of risk that the customer is willing to assume; and (2) ensure that the customer is aware of the increased risks associated with the departure from the customer's instructions. *Dist. Bus. Conduct Comm. v. Prudential-Bache Sec., Inc.*, Complaint No. NEW-606, 1991 NASD Discip. LEXIS 3, at *12-13 (Bd. of Governors, Jan. 2, 1991); s*ee also John F. Yakimczyk*, 51 S.E.C. 56, 57-58 (1992) (finding that registered representative violated NASD rules by failing to follow promptly a customer's instructions to

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[5] NASD Conduct Rule 115 makes all NASD rules, including NASD Conduct Rule 2110, applicable to both NASD members and all persons associated with NASD members.

sell her holdings where the representative wanted to wait for a more favorable time to sell and ignored the customer's instructions to sell for several months).[6]

Here, we find that respondents invested SJT program funds in high-risk securities for years without their customers' authorization, in violation of NASD Conduct Rule 2110. The investment objectives of respondents' customers who agreed to participate in the SJT program were clear. The SJT program customers all identified themselves as seeking moderate risk and never authorized the respondents to invest their SJT funds in high-risk securities for an extended time period. Respondents' actions after September 2000, however, disregarded the investment objectives of the SJT program participants.

Prior to September 2000, respondents pursued a market-timing strategy that placed the SJT program funds in high-risk securities for only brief periods. The rest of the time, respondents invested the funds in money market funds. In other words, the SJT program customers' funds were handled in accordance with the instructions that the customers agreed to when they entered the program.[7] After September 2000, however, the respondents placed all of the SJT program customers' funds into high-risk securities and kept them there. This action exceeded the scope of respondents' authority. Moreover, the respondents' actions ignored the customers' instructions to limit the risk via the market-timing strategy that was promoted to the customers and was the foundation of the SJT program.

The respondents did not seek authorization from their customers to hold on to such a high-risk investment. In fact, respondents admit that at no time over the past four years have they attempted any formal communication to their customers regarding the higher level of risk

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[6] Two instances in *Yakimczyk* where the District Business Conduct Committee ("DBCC") did not find liability for unauthorized trading are distinguishable based on the specific facts of this case. First, in *Yakimczyk*, the DBCC did not find that respondent violated just and equitable principles of trade by failing to follow one of his customer's instructions to sell because the customer requested that his holdings be sold at a price that was substantially higher than market price and respondent therefore could not execute the order. Second, the DBCC did not find respondent liable for ignoring another customer's instruction to sell immediately the customer's holdings of a particular stock where respondent *promptly* sold the stock for the best price he could obtain. Here, however, respondents ignored their SJT customers' instructions to limit risk via a market-timing strategy for over four years and there were no additional instructions from the SJT customers that prevented respondents from pursuing the market-timing strategy that the customers agreed to when they entered the SJT program.

[7] Although the respondents had written authority to make investment decisions for their SJT program customers, we note that respondents never promoted the SJT program as a high-risk investment and consistently advised their customers that the SJT program involved only moderate risk because the funds would be invested in high-risk securities for brief time periods. We therefore find that respondents' discretionary authority was limited by their representations that they would only expose the SJT funds to moderate risk.

associated with maintaining this investment, even though many of these customers were retirees or unsophisticated investors. We find that the respondents' investment of the SJT program funds in high-risk securities for such an extended time period without receiving authorization from their customers shows bad faith and is unacceptable under the high ethical standards that NASD requires of its membership. *See Larry Ira Klein*, 52 S.E.C. 1030, 1032 (1996) (finding that respondent violated NASD's ethical standards established under NASD Conduct Rule 2110 by failing to inform customers about the high risk of the investments that he was recommending).

Respondents, however, argue that investing the SJT funds in high-risk securities for an extended time period was appropriate for their customers who had lost money in the SJT program prior to September 2000. Respondents believed that market conditions required them to expose these customers to higher risk for an extended time period in order to recover the customers' pre-September 2000 losses. Respondents further argue that under the SJT program, respondents were authorized to pursue high-risk investments over an extended time if such action was necessary to recover the losses of a down market. None of these arguments are persuasive.

Prior to September 2000, the SJT program customers authorized a market-timing investment strategy that purportedly involved only moderate risk and did not create an exception in the event of a market downturn. Moreover, even if the down market justified implementing a change in this market-timing strategy, respondents should have disclosed the fact that they were modifying the approved market-timing strategy and sought authorization for the riskier strategy from their customers. *See Paul F. Wickswat*, 50 S.E.C. 785, 787 (1991) (ruling that registered representative was "obliged to disclose fully the risks involved and obtain either a meaningful consent to the adoption of new investment objectives or an assent to a limited departure" from his customer's general investment objectives in order to adopt a high-risk trading strategy that was at odds with his customer's stated investment objectives). We agree with the Hearing Panel that respondents adopted a high-risk strategy that was never authorized by their customers and represented a material change from the market-timing strategy authorized under the SJT program.[8] Consequently, we find that respondents violated NASD Conduct Rule 2110 by employing an unauthorized high-risk investment strategy.[9]

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[8] Respondents claim that their customers were notified of the change in how the SJT funds were invested via their account statements. We find, however, that sending these account statements did not relieve respondents of their duty to inform their customers of the increased risk associated with this change and did not amount to authorization to pursue a high-risk strategy. *Cf. Paul F. Wickswat*, 50 S.E.C. at 786-87 (finding that a customer's acquiescence to her representative's risky trading strategy was not intended to change her stated investment objective of preserving principal).

[9] Respondents contend that the Hearing Panel's finding of liability is precluded by the fact that a May 21, 2001 examination by NASD staff failed to uncover any violations by respondents in connection with the SJT program. It is well settled, however that "[a] regulatory authority's failure to take early action neither operates as an estoppel against later action nor cures a violation." *William H. Gerhauser, Jr.*, 53 S.E.C. 933, 940 (1998) (citations omitted).

B. The Respondents Violated NASD's Suitability Rule

NASD Conduct Rule 2310, commonly referred to as the suitability rule, requires that in recommending the "purchase, sale or exchange" of a security to a customer, a member or associated person must have a reasonable basis for believing that the recommendation is suitable for the customer based on the customer's financial needs and objectives. *Rafael Pinchas*, 54 S.E.C. 331, 341 (1999). The Hearing Panel found that NASD Conduct Rule 2310 was not literally applicable in this case. This is because the Hearing Panel concluded that although the respondents had discretionary authority over the SJT accounts, their recommendations did not involve the purchase, sale, or exchange of a security. We disagree.

We have previously held that the obligation to recommend only suitable transactions extends to discretionary transactions because "when a broker effects transactions in an account over which he has discretionary authority, the transactions are implicitly recommended." *Dep't of Enforcement v. Lu*, Complaint No. C9A020052, 2004 NASD Discip. LEXIS 8, at *28 (NAC May 13, 2004) (citation omitted), *aff'd on other grounds*, Exchange Act Rel. No. 51047, 2005 SEC LEXIS 117 (Jan. 14, 2005), *appeal docketed*, No. 05-8006 (D.C. Cir. Mar. 14, 2005). Here, when the respondents decided to change materially the SJT program, they made a new recommendation that involved a substantially higher level of risk than their initial recommendation. *See Prudential-Bache*, 1991 NASD Discip. LEXIS 3, at *8-9. Prior to September 2000, the respondents' recommendation to buy high-risk securities near the end of each month was coupled with a recommendation to quickly sell these securities. After September 2000, the respondents' recommendation was designed to maximize expected long-term gains by selling the high-risk securities whenever the market recovered. Although the respondents' plan was poorly conceived, poorly executed and not authorized, respondents were nevertheless recommending transactions in carrying out their new, high-risk plan.

The SJT customers' investment objectives were moderate risk, not high risk. In fact, the SJT program customers entered the program because they believed it was consistent with their stated investment objectives of moderate risk. The respondents changed the SJT program when they decided that these customers should make a long-term investment in high-risk securities. The respondents made this decision despite the fact that SJT customers were not in a position to absorb losses that could result from a long-term investment in high-risk, volatile securities. Consequently, we find that the respondents did not have a reasonable basis for their post-September 2000 recommendation. This recommendation was inconsistent with their customers' stated investment objectives and was therefore unsuitable.[10]

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[10] The Hearing Panel found that the respondents independently violated Conduct Rule 2110 by failing to make any determination as to whether their post-September 2000 recommendation was suitable for their customers. The Hearing Panel's finding was based on the notion that respondents disregarded their ethical obligations under Conduct Rule 2110. In the proceeding below, however, Enforcement consistently argued that respondents' post-September 2000 recommendation violated the suitability rule. At no point during the proceedings did

[Footnote continued on next page]

C. Wiard Exercised Discretionary Authority in Violation of NASD's Instructions

We find that an associated person who disregards an express prohibition imposed in a final decision of an NASD adjudicator has violated NASD Conduct Rule 2110. We have previously held—and the Commission has confirmed—that under the SJT program, Wiard managed discretionary accounts in violation of the express conditions we imposed in approving Royal Alliance's MC-400 Application. *See Scott E. Wiard*, Exchange Act Rel. No. 50393, 2004 SEC LEXIS 2112, at *8 (Sept. 16, 2004). In light of the Commission's decision, we reject Wiard's argument in this proceeding that his participation in the SJT program did not involve his handling of discretionary accounts and find that such participation violated NASD Conduct Rule 2110.

Wiard argues that because the conviction that prompted Royal Alliance to file its MC-400 Application has been set aside, all findings of liability arising from the conviction should be dismissed. Specifically, Wiard contends that he cannot be held liable for his failure to abide by the conditions we imposed on him in approving Royal Alliance's MC-400 Application because those conditions were imposed as a result of his conviction. A conviction, however, is a final decision for the purpose of attaching liability. *See Paul M. Kaufman*, 44 S.E.C. 374, 376 (1970) (finding that a conviction is a final judgment with respect to the disqualification of a lawyer to practice before the Commission). In *Kaufman*, the Commission stated that "[o]nce the judgment of conviction was entered, [the] respondent was no longer entitled to the presumption of innocence, and he stands convicted until such time as the conviction is reversed or set aside." *Id.*

Wiard's conviction was not set aside until after Wiard had violated the conditions of his firm's MC-400 application. The fact that Wiard's conviction was set aside, therefore, is irrelevant with respect to our finding that Wiard violated the conditions that we imposed in connection with Royal Alliance's MC-400 Application. We therefore conclude that the Hearing Panel correctly found that Wiard was still subject to a statutory disqualification and all the conditions set forth in our approval of his Firm's MC-400 Application. *Cf. William F. Lincoln*, 53 S.E.C. 452, 456 (1998) (refusing to set aside administrative proceeding until respondent's criminal conviction was reversed when respondent had appealed his criminal conviction and proceeding was instituted solely on the basis of the conviction). Consequently, Wiard's violation of those conditions exposed him to liability under NASD Conduct Rule 2110.

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Enforcement specifically allege or argue that respondents' recommendation to invest in high-risk securities over the long term was unethical. We therefore cannot conclude that the respondents had reasonable notice of an independent ethical violation under Conduct Rule 2110. Because we find a violation of the suitability rule, we express no opinion concerning whether respondents' post-September 2000 recommendation independently violated the ethical standards established by Conduct Rule 2110.

Moreover, the appropriate avenue for Wiard to seek modification of the conditions imposed upon him because of his status as a disqualified individual rests in the MC-400 application process. While Wiard may no longer be subject to statutory disqualification, there is no evidence in the record that Wiard notified the Central Registration Depository® or NASD's Department of Member Regulation ("Member Regulation") that his conviction had been set aside or sought any relief from the conditions imposed upon him under the MC-400 application process prior to his violation. Consequently, we reject Wiard's argument that we should excuse his failure to abide by these conditions.

D. Wiard Failed to Amend His Form U4

Under NASD By-Laws, every person registered with an NASD member must complete a Form U4.[11] All registered persons are responsible for updating their Form U4 and a failure to do so violates NASD Conduct Rule 2110. *Dep't of Enforcement v. Howard*, Complaint No. C11970032, 2000 NASD Discip. LEXIS 16, at *31 (NAC Nov. 16, 2000), *aff'd, Daniel Richard Howard*, Exchange Act Rel. No. 46269, 2002 SEC LEXIS 1909 (July 26, 2002). Here, Wiard never prepared and submitted an updated Form U4 to his firm to include an October 2001 complaint, and he allowed two years to pass before preparing and submitting an amended Form U4 to include a December 2001 complaint. We therefore affirm the Hearing Panel's conclusion that Wiard violated NASD Conduct Rule 2110 by failing to update his Form U4.

V. Sanctions

The NASD Sanction Guidelines ("Guidelines") covering unauthorized transactions and suitability violations are similar in that each recommend a suspension of 10 business days to one year, or a longer suspension of up to two years or a bar in egregious cases.[12] The Guidelines for unauthorized transactions, however, recommend a fine of $5,000 to $75,000 for violations, while the Guidelines covering suitability rule violations recommend a fine ranging from $2,500 to $75,000.[13]

Along with the specific recommendations in the Guidelines for each of the unauthorized trading and suitability violations, we have considered the Principal Considerations for Determining Sanctions set forth in the Guidelines. We find that each violation provides an independent basis for barring the respondents. Moreover, we find it aggravating that respondents' unauthorized trading and unsuitable recommendations occurred over a period of

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11 NASD By-Laws, Art. V, §2(c).

12 *See* Guidelines (2001 ed.) at 99 (Suitability – Unsuitable Recommendations), 102 (Unauthorized Transactions and Failures to Execute Buy and/or Sell Orders)

13 *Id*.

more than four years.[14] We also find it aggravating that respondents' misconduct involved more than 60 customers.[15]

Finally, we find respondents' failure to inform some of their customers, a number of which were unsophisticated investors or retirees, of the heightened risk of abandoning the market timing strategy to be in bad faith. Respondents fundamentally disregarded their customers' investment objectives and instructions. We therefore agree with the Hearing Panel that respondents' misconduct was egregious and affirm the Hearing Panel's imposition of a bar for respondents' unauthorized trading and suitability rule violations.[16]

VI. Conclusion

We find that the respondents made unauthorized investments with their customers' funds and violated the suitability rule. We also find that Wiard exercised discretionary authority in violation of NASD's instructions and failed to update his Form U4. We reject the respondents' argument that the SJT program authorized the use of a high-risk strategy in order to recover customer losses occurring prior to September 2000.[17] We therefore affirm the sanctions imposed by the Hearing Panel to reflect these findings[18] and impose appeal costs of $1,000 and transcript costs of $367.04 against respondents, jointly and severally.

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14 *See* Guidelines (2001 ed.) at 9-10 (Principal Considerations in Determining Sanctions).

15 *Id.*

16 Wiard's other violations would call for lesser sanctions. In light of the bar, we decline to impose additional sanctions for these violations. We note, however, that Wiard's failure to abide by the conditions of our approval of his Firm's MC-400 application demonstrates a disregard for NASD's regulatory authority. This disregard for our authority mirrors the disregard he has shown for his customers' investment objectives since September 2000 and provides additional support for our decision to impose a bar against him.

17 We have considered and reject without discussion all other arguments advanced by the parties.

18 We also uphold the Hearing Panel's imposition of hearing costs against respondents in the amount of $2,538.50, jointly and severally.

Accordingly, both Wiard and Reisinger are barred from associating with any NASD member firm in any capacity. We impose a separate bar on respondents for their suitability violations under Conduct Rule 2310, and for their unauthorized trading violations under Conduct Rule 2110. The bars will be effective upon service of this decision.

On Behalf of the National Adjudicatory Council,

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Barbara Z. Sweeney, Senior Vice President and Corporate Secretary