Gary J. Dernelle
Associate General Counsel

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December 20, 2007

VIA MESSENGER

Nancy M. Morris, Secretary
Securities and Exchange Commission
100 F Street, N.E., 10th Floor
Room 10915 – Mailstop 1090
Washington, D.C. 20549-1090

RE: Complaint No. C9B040098: Scott Epstein

Dear Ms. Morris:

Enclosed please find the decision of the National Adjudicatory Council ("NAC") in the above-referenced matter. The Board of Governors of the Financial Industry Regulatory Authority ("FINRA") did not call this matter for review, and the attached NAC decision is the final decision of FINRA.

Very truly yours,

Gary J. Dernelle

Enclosure

cc: Tonya Howe

Barbara Z. Sweeney
Senior Vice President and
Corporate Secretary

Direct: (202) 728-8062
Fax: (202) 728-8075

December 20, 2007

VIA CERTIFIED MAIL/RETURN RECEIPT REQUESTED
FIRST-CLASS MAIL/VIA FACSIMILE

George L. Mahr II, Esq.
Mahr and Mahr, LLC
80 Main Street
P.O. Box 534
Madison, New Jersey 07940
Facsimile: 973-377-3705

Re: Complaint No. C9B040098: Scott Epstein

Dear Mr. Mahr:

Enclosed is the decision of the National Adjudicatory Council ("NAC") in the above-referenced matter. The Board of Governors of the Financial Industry Regulatory Authority ("FINRA") did not call this matter for review, and the attached NAC decision is the final decision of FINRA.

In the enclosed decision, the NAC found that Scott Epstein ("Epstein") recommended unsuitable mutual fund switch transactions, in violation of NASD Rule 2310, 2110, and IM-2310-2. For this misconduct, the NAC has barred Epstein in all capacities.

Please note that, under IM-8310-1 ("Effect of a Suspension, Revocation or Bar"), because the NAC has imposed a bar, effective immediately Epstein is not permitted to associate with any FINRA member firm in any capacity, including a clerical or ministerial capacity.

Pursuant to Article V, Section 2 of the FINRA By-Laws, if Epstein is employed currently with a member of FINRA, he is required immediately to update his Form U4 to reflect this action. Furthermore, Article V, Section 2 of the FINRA By-Laws requires all persons who apply for registration with FINRA to submit a Form U4 and to keep all information on the Form U4 current and accurate.

In addition, FINRA may request information from, or file a formal disciplinary action against, persons who are no longer registered with a FINRA member for at least two years after their termination from association with a member. See Article V, Sections 3 and 4 of FINRA's By-Laws. Requests for information and disciplinary complaints issued by FINRA during this two-year period will be mailed to such persons at their last known address as reflected in FINRA's records. Such individuals are deemed to have received correspondence sent to the last known address, whether or not the individuals have actually received them. Thus, individuals who are no longer associated with a FINRA member firm and who have failed to update their addresses during the two years after they end their association are subject to the entry of default decisions against them. See Notice to Members 97-31. Letters notifying FINRA of such address changes should be sent to:

CRD
P.O. Box 9495
Gaithersburg, MD 20898-9401

Epstein may appeal this decision to the U.S. Securities and Exchange Commission ("SEC"). To do so, he must file an application with the SEC within 30 days of your receipt of this decision. A copy of this application must be sent to the FINRA Office of General Counsel, as must copies of all documents filed with the SEC. Any documents provided to the SEC via facsimile or overnight mail should also be provided to FINRA by similar means.

The address of the SEC is:

The Office of the Secretary
Securities and Exchange Commission
100 F Street, N.E.
Mail Stop 1090 – Room 10915
Washington, D.C. 20549

The address of FINRA is:

Attn: Gary J. Dernelle
Office of General Counsel
FINRA
1735 K Street, N.W.
Washington, D.C. 20006

If Epstein files an application for review with the SEC, the application must identify the FINRA case number, state the basis for his appeal, and include an address where he or his legal counsel may be served and a day-time phone number. Attorneys must file a notice of appearance.

The filing with the SEC of an application for review shall stay the effectiveness of any sanction except a bar or expulsion. Thus, the costs imposed by the NAC in the enclosed decision will be stayed pending appeal to the SEC. The bar imposed by the NAC in the enclosed decision will not be stayed pending appeal to the SEC, unless the SEC orders a stay.

Questions regarding the appeal process may be directed to the Office of the Secretary at the SEC. The phone number of that office is (202) 551-5400.

If Epstein does not appeal this NAC decision to the SEC, he may pay the monetary sanctions and costs assessed in the enclosed decision after the 30-day period for appeal to the SEC has passed. Any fines and costs assessed should be paid (via regular mail) to FINRA, P.O. Box 7777-W8820, Philadelphia, PA 19175-8820 or (via overnight delivery) to FINRA, W8820-c/o Mellon Bank, Room 3490, 701 Market Street, Philadelphia, PA 19106.

Very truly yours,

Barbara Z. Sweeney
Senior Vice President and Corporate Secretary

Enclosure

cc: Scott Epstein
Michael J. Newman, Esq.
Leo F. Orenstein, Esq.
Damian Williams, Regulatory Rev & Disclosure
Christopher Dragos, Regulatory Rev & Disclosure
Zita Tepie, Finance

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of Department of Enforcement, Complainant, vs. Scott Epstein Marlboro, NJ, Respondent.	DECISION Complaint No. C9B040098 Dated: December 20, 2007

Registered representative recommended unsuitable mutual fund switch transactions to customers. Held, Hearing Panel's findings of liability affirmed, in part, and sanctions affirmed.

Appearances

For the Complainant: Michael J. Newman, Esq., Leo F. Orenstein, Esq., Department of Enforcement, Financial Industry Regulatory Authority

For the Respondent: George L. Mahr II, Esq.

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BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of Department of Enforcement, Complainant, vs. Scott Epstein Marlboro, NJ, Respondent.	DECISION Complaint No. C9B040098 Dated: December 20, 2007

Decision

Scott Epstein ("Epstein") appeals an October 31, 2005 Hearing Panel decision under NASD Rule 9311. After a thorough review of the record, we affirm the Hearing Panel's findings that Epstein made unsuitable mutual fund switch recommendations to customers. We also bar Epstein for this misconduct. Given these results, we find it unnecessary to examine the Hearing Panel's findings that Epstein's misconduct was accompanied by fraudulent misrepresentations and omissions of material facts.

I. Background

A. Employment History

Epstein entered the securities industry shortly after graduating from college in June 2000. He was hired by Merrill Lynch, Pierce, Fenner & Smith, Inc. ("Merrill Lynch") in August 2000 and became a registered general securities representative of the firm on September 25, 2000. Merrill Lynch terminated Epstein's registration on November 15, 2002, due to a reduction in force. He is not presently associated with any FINRA member firm.[1]

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[1] As of July 30, 2007, NASD consolidated with the member firm regulation functions of NYSE and began operating under a new corporate name, the Financial Industry Regulatory Authority ("FINRA"). References in this decision to FINRA shall include, by reference and where appropriate, references to NASD.

B. Procedural Background

FINRA staff began investigating Epstein after receiving a written complaint from customer RR in August 2002. RR stated in her complaint that Epstein had effected unauthorized mutual fund switch transactions in her accounts.[2] After reviewing a statement that Epstein prepared in response to RR's complaint and a taped recording of Epstein's conversations with RR, FINRA staff expanded their investigation to review all mutual fund transactions effected by Epstein during the period of September 2001 until the date of his termination. After reviewing these transactions, FINRA staff requested that Merrill Lynch provide FINRA with the account statements and taped conversations for a sample of 16 customer accounts for which Epstein had effected mutual fund switch transactions from October 2001 through February 2002.

In a 24 cause complaint dated November 11, 2004, FINRA's Department of Enforcement ("Enforcement") charged Epstein with misconduct in violation of the federal securities laws and NASD rules. Enforcement alleged that, between October 2001 and February 2002, Epstein engaged in a pattern of recommending and effecting unsuitable mutual fund switch transactions for 12 Merrill Lynch customers, in violation of NASD Rules 2310, 2110, and IM-2310-2. Enforcement claimed that each of the transactions in question provided the customers with little or no advantage over their initial mutual fund investments, resulted in additional and unnecessary expenses and charges for the customers, and afforded Epstein with compensation that he would not have received absent a switch between mutual funds of different fund families. Enforcement also alleged that Epstein, in recommending each of the mutual fund switches, misrepresented and omitted material facts, in violation of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), Exchange Act Rule 10b-5, and NASD Rules 2120, 2110, and IM-2310-2. Epstein was said, among other things, to have stated misleadingly that certain switch transactions would be at "no cost" and to have failed to disclose the names of the funds recommended, the options available to customers regarding the classes of shares offered by the recommended funds, the costs and expenses associated with each recommended fund share, and the existence of cost saving options that were available to customers.

Epstein failed to file an answer to the complaint on or before December 9, 2004, the date it was due.[3] Instead, in a 16-page letter addressed to the Hearing Officer dated January 18, 2005, Epstein, through his counsel, requested an enlargement of the period of time to file an answer until February 28, 2005. In his letter, Epstein claimed, among other things, that he was being made a "scapegoat" by Merrill Lynch. Epstein further claimed that an enlargement of time was necessary in order for him to conduct an investigation of the transactions in question and to explore certain affirmative defenses that Epstein intended to include in his answer, including the

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[2] "Switches" or "switching" involves one or more mutual fund redemption transactions with one or more related mutual fund purchase transactions. *Russell L. Irish*, 42 S.E.C. 735, 737, n.4a (1965), *aff'd*, 367 F.2d 637 (9th Cir. 1966).

[3] On December 22, 2004, Enforcement served a second notice of complaint, requiring an answer to be filed on or before January 10, 2005. Respondent also failed to file an answer by this date.

assertion that Epstein was simply "following orders" and was being "selectively" profiled by FINRA in violation of his civil rights.

On January 19, 2005, the Hearing Officer issued an order extending the time for Epstein to file an answer to February 7, 2005. On February 15, 2005, eight days late, the Office of Hearing Officers ("OHO") received an answer from Epstein dated February 10, 2005.[4] In his answer, Epstein denied the allegations of misconduct set forth in Enforcement's complaint. Epstein also asserted several "affirmative defenses" claiming that Enforcement's complaint had been filed to interfere with and delay an arbitration claim filed by Epstein against Merrill Lynch and certain Merrill Lynch officials.

The Hearing Officer held a pre-hearing conference with the parties on March 11, 2005. During the pre-hearing conference, Epstein's counsel again asserted that his client was guiltless, merely following the instructions of others at Merrill Lynch, and was being selectively prosecuted by FINRA. Epstein's counsel expressed his desire to obtain wide-ranging discovery concerning the actions of Merrill Lynch and the individual respondents named in Epstein's arbitration claim. The Hearing Officer informed Epstein's counsel that the disciplinary hearing in this matter would be limited to the allegations set forth in Enforcement's complaint and the issue of what sanctions, if any, were to be imposed upon his client should he be held liable for violating the federal securities laws and NASD rules. The Hearing Officer thus stated that the disciplinary hearing could not be used by Epstein to obtain information concerning issues unrelated to the claims set forth in Enforcement's complaint. The Hearing Officer, over Epstein's counsel's objections, scheduled a hearing on the matter for the week of July 11 through July 15, 2005.

Thereafter, on April 27, 2005, Enforcement moved to strike Epstein's "affirmative defenses." Enforcement stated that Epstein's purported affirmative defenses lacked any factual truth and were legally irrelevant. Epstein did not file an opposition to Enforcement's motion. The Hearing Officer, finding that Epstein's affirmative defenses did not constitute valid defenses to the causes of the complaint, granted Enforcement's motion to strike them on May 17, 2005.

On April 28, 2005, Epstein filed an application requesting that the Hearing Officer direct Enforcement to produce certain documents and information, including any documents that would "exculpate" Epstein, any documents that would allegedly "implicate" Merrill Lynch officials, any "Wells" letters or disciplinary complaints issued against those individuals, and any records of interviews conducted by FINRA staff with the Merrill Lynch officials. Enforcement opposed Epstein's application in a response dated May 11, 2005. Enforcement stated that it had complied with its production obligations under NASD Rule 9251 and had provided Epstein with all materially exculpatory evidence to which he was entitled under NASD's Code of Procedure. Enforcement further objected to what it viewed as Epstein's attempt to use the disciplinary

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4 Because Epstein failed to file timely an answer to Enforcement's complaint, the Hearing Officer issued an order on February 14, 2005, requiring that Epstein show cause, on or before February 21, 2005, why he should not be held in default. On February 18, 2005, having received Epstein's answer, the Hearing Officer issued an order stating that Epstein would not be held in default for failing to file timely an answer to the complaint.

proceedings to obtain discovery for his arbitration against Merrill Lynch and individuals who were not parties to the disciplinary proceedings.

The Hearing Officer denied Epstein's application on May 17, 2005. The Hearing Officer found that Epstein provided no evidence that Enforcement had failed to comply with its obligation to produce documents under NASD Rule 9251. The Hearing Officer further found that Epstein's requests for documents and information did not seek information relevant to the issues presented by Enforcement's complaint.

On June 2, 2005, Epstein filed an "amended and supplemental notice of motion" alleging that the Hearing Officer's pre-hearing scheduling order, his order striking Epstein's affirmative defenses, and his order denying respondent's application for the production of documents were "arbitrary and capricious." Epstein repeated his requests for the production of exculpatory documents and information concerning Merrill Lynch and its officials. Epstein also requested a protective order seeking, among other things, a stay of his disciplinary hearing until after the completion of his arbitration proceeding, the ability to issue subpoenas for the purpose of taking the depositions of Merrill Lynch and FINRA officials, to suppress the testimony given by Epstein during an on-the-record interview with FINRA staff, and to dismiss Enforcement's complaint because Enforcement had failed to disclose to Epstein that a member of its investigation staff had previously been employed by Merrill Lynch and because of "internal conflicts of interest" that existed between Epstein, Enforcement, OHO, and FINRA Dispute Resolution.

The Hearing Officer issued an order denying Epstein's motion on June 6, 2005. The Hearing Officer found that Epstein had provided no rationale for the relief sought. The Hearing Officer's order further stated that Epstein's "complaints against high-ranking Merrill-Lynch representatives, which are the subject of a pending arbitration, may not be litigated in this disciplinary proceeding, nor will the purpose, adequacy, or techniques of FINRA's investigation of the facts that led to this disciplinary matter be litigated during the hearing."

On June 13, 2005, Enforcement filed its pre-hearing brief, witness list, and exhibits. Epstein also filed his pre-hearing brief on this date. In his 76-page filing, however, Epstein chose to address his pending arbitration claim against Merrill Lynch and the individual respondents. Epstein's brief did not address the substance of Enforcement's claims that Epstein had violated the federal securities laws and NASD rules by engaging in unsuitable mutual fund switches and fraud. Epstein also did not a file with OHO or serve upon Enforcement a witness list or a copy of any exhibits.

Enforcement therefore filed a motion on June 20, 2005, requesting that the Hearing Officer preclude Epstein from offering any testimony, other than his own, or documents into evidence at the hearing under NASD Rule 9280(b)(2). Enforcement based its motion upon Epstein's failure to comply with the Hearing Officer's May 11, 2005 pre-hearing order to file documents that he intended to use as exhibits and a list of the witnesses he intended to call at hearing. Enforcement asserted that it would be prejudiced by Epstein's failure to adhere to the requirements of the Hearing Officer's pre-hearing order.

Epstein opposed Enforcement's motion for a preclusion order in a filing dated July 1, 2005. Epstein requested that the Hearing Officer deny Enforcement's request for a preclusion order and then set forth 17 requests for relief that would essentially vacate each of the Hearing Officer's prior orders in the case, force the recusal of an Enforcement attorney and FINRA investigator, and stay the disciplinary proceedings until Enforcement completed an investigation into the activities of Merrill Lynch and each of the individual arbitration respondents. In support of this filing, Epstein's counsel filed a 21-page declaration stating that Enforcement had not produced certain exculpatory documents, Enforcement was selectively prosecuting him, Enforcement was keeping open an investigation into the activities of Merrill Lynch and the individual arbitration respondents to his prejudice, the Hearing Officer's orders evidenced bias, and FINRA and the securities industry generally were colluding to harass and intimidate his client.

The Hearing Officer issued an order granting Enforcement's request for a preclusion order on July 6, 2005. The Hearing Officer stated that Epstein had neither complied nor explained his non-compliance with the Hearing Officer's pre-hearing order concerning the filing of motions and the production of witness lists and exhibits. The Hearing Officer reiterated that the disciplinary proceeding could not be used, and would not be postponed, to allow Epstein the opportunity to investigate or litigate matters that were the subject of his pending arbitration or to delve into FINRA's investigative practices. The Hearing Officer's order, finding the absence of good cause, denied Epstein's request for the relief sought by him in his July 1, 2005 filing.

A hearing concerning Epstein's alleged misconduct was held on July 11 and 12, 2005, before an extended hearing panel composed of the Hearing Officer and two former members of FINRA's District No. 10 Committee. During the hearing, Enforcement presented the testimony of: 1) the FINRA compliance specialist that had investigated Epstein's mutual fund switch recommendations; 2) the person at Merrill Lynch responsible for retrieving the taped recordings of Epstein's conversations with customers; and 3) an expert witness who had reviewed each of the transactions that were the subject of Enforcement's complaint and who had opined that they were unsuitable and misleading. Enforcement also offered into evidence 71 exhibits, including taped recordings and transcripts of Epstein's conversations with each of the customers to whom Epstein had allegedly made the questionable recommendations.

On the second day of the hearing, Enforcement called Epstein to testify. Although having been notified of his duty to appear and provide testimony under NASD Rule 8210, Epstein did not do so. Epstein's counsel then left the hearing without presenting any evidence on his client's behalf. The hearing continued without Epstein in attendance. Epstein thus abandoned any defense on the merits he may have had concerning the allegations set forth in Enforcement's complaint. After the completion of its case, Enforcement indicated its intention to file a motion for the issuance of a default based upon Epstein's failure to appear and his counsel's abandonment of Epstein's defense at hearing.

On July 28, 2005, Epstein moved to disqualify the Hearing Officer assigned to this matter for bias and prejudice allegedly exhibited in the course of the disciplinary proceeding and to stay the disciplinary proceedings. Epstein's motion was supported by a 61-page declaration signed by his counsel, the disciplinary hearing transcripts, and various motions, orders, and other papers filed or issued in the proceeding. In his declaration, Epstein's counsel asserted that the Hearing

Officer "carried out the preconceived strategy of the Office of Hearing Officers and [Enforcement] to deprive the Respondent of his Constitutional Rights to an attorney, to due process and his right to a fair hearing by discriminating against him from the inception of the disciplinary action as an integral part of the strategy used by the [Hearing Officer] to intentionally accelerate the hearing date and all other discovery and motion dates." Epstein further charged that "NASD, [Enforcement], . . . have conspired and collaborated with Merrill Lynch to retaliate against and intimidate Scott Epstein in a scheme and artifice to cover-up the wrongdoings of the real culprits."

The Deputy Chief Hearing Officer, pursuant to delegated authority, issued an order on August 4, 2005, denying Epstein's disqualification motion. The Deputy Chief Hearing Officer found that Epstein neither articulated any reasonable basis for believing that the Hearing Officer was biased nor presented any evidence that would cause an objective disinterested observer to question the Hearing Officer's fairness. The Deputy Chief Hearing Officer concluded instead that Epstein's motion "rests primarily on unsubstantiated accusations regarding an improbable conspiracy, which no objective, disinterested observer would find sufficient to require disqualification."

The Hearing Panel issued its decision in this matter on October 31, 2005.[5] The Hearing Panel stated that Enforcement had shown good cause for the granting of a default under NASD Rule 9269. The Hearing Panel determined, however, that a sufficient record had been established and that it would base its decision on the entire record. The Hearing Panel found that, as alleged in Enforcement's complaint, Epstein had made unsuitable mutual fund switch recommendations to customers, in violation of NASD Rules 2310, 2110, and IM-2310-2. The Hearing Panel also found that Epstein made material misrepresentations of fact and omitted material facts in the course of making the switch recommendations, in violation of Section 10(b) of the Exchange Act, Exchange Act Rule 10b-5, and NASD Rules 2120, 2110, and IM-2310-2. The Hearing Panel ordered that Epstein be barred from associating with any FINRA member in any capacity as a sanction for the foregoing misconduct.

Epstein timely appealed the Hearing Panel's decision.

II. Facts

A. The Merrill Lynch Financial Advisory Center

Epstein was employed at Merrill Lynch's Hopewell, New Jersey "Financial Advisory Center." The Financial Advisory Center was organized to accept the transfer of pre-existing accounts from Merrill Lynch branch offices. Accounts transferred to the Financial Advisory Center generally included those with balances of less than $100,000 or those that had experienced periods of inactivity. Customers were not told in advance that their accounts were being transferred to the Financial Advisory Center. Customers simply received a letter from

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[5] On August 10, 2005, as directed by the Hearing Panel, Enforcement filed its post-hearing brief and a motion for default. Epstein did not file a post-hearing submission or a response to Enforcement's motion for the issuance of a default.

Merrill Lynch welcoming them and encouraging them to call the Financial Advisory Center to speak to a Merrill Lynch representative.

"Investment Services Advisors," registered representatives including Epstein, serviced the accounts transferred to the Financial Advisory Center. No one Investment Services Advisor was dedicated to any one customer account, and they were not permitted to solicit new customer accounts. The Investment Services Advisors instead would randomly receive incoming telephone calls from Financial Advisory Center customers, as well as make unsolicited telephone calls to targeted customers for the purpose of reviewing their accounts. Epstein approximates that he received or made as many as 100 customer calls each day.

Mutual fund transactions predominated at the Financial Advisory Center. Epstein's primary securities activity on behalf of customers was recommending and effecting transactions involving the sale of one mutual fund and the purchase of another mutual fund with the sales proceeds. Merrill Lynch's compliance policies and procedures, which Epstein attested to having received and read, required all registered representatives to discuss with customers the investment objectives, strategies, and risks associated with investing in any recommended mutual fund that Merrill Lynch sold. Registered representatives were also required to disclose any fees and expenses associated with a recommended mutual fund and their effect on potential returns. Representatives were obliged, among other things, to discuss with customers the advantages and disadvantages of the various mutual fund share classes available for investment.[6]

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[6] Generally, each mutual fund is composed of several classes of shares. Each class represents a similar interest in the mutual fund's portfolio of assets. They differ in the sales charges that customers must pay to acquire or sell shares and in amounts that each share class may bear of the fund's expenses.

Class A mutual fund shares usually include an initial, or "front-end," sales charge or "load," a fee that is levied upon the purchase of shares.

Class B shares usually include a contingent deferred sales charge ("CDSC"), or "back-end load," which is a fee that is levied upon the sale of mutual fund shares. Typically, the CDSC is reduced with each year that the investor holds the fund shares, phasing out entirely after a certain number of years. At some point afterward, the Class B shares typically convert to Class A shares or another class of shares with lower operating expenses.

Class C shares, like B shares, also impose a CDSC. The CDSC for Class C shares is, however, typically eliminated one year after purchase.

The expenses associated with each class of shares of a mutual fund are expressed in the form of an operating expense ratio which measures a fund's total annual expenses as a percentage of the fund's net assets. The expense ratio includes asset-based sales charges, such as charges permitted under Investment Company Act Rule 12b-1, that are taken from the mutual fund's assets to pay to market the fund and distribute its shares. The expense ratios for Class B and Class C shares are generally higher than the expense ratio for Class A shares because the asset-based sales charges associated with Class A shares are lower. Since Class C shares

[Footnote continued on next page]

Representatives were also required to discuss any restrictions on or costs associated with redemptions, the existence and effect of any ongoing distribution or maintenance fees, available discounts, breakpoints, and rights of accumulation, and the availability of no-cost or low cost exchanges within fund families and between different fund groups.[7] Merrill Lynch's compliance policies specifically prohibited registered representatives from recommending any mutual fund "switch" transaction that would not result in a net investment advantage for the customer, after considering all financial and other factors, including sales charges and tax consequences.[8]

Merrill Lynch also provided Investment Services Advisors with written guidance, a "script," that included detailed information to be discussed with customers concerning the different classes of mutual fund shares. The script included information concerning class A (or D), B, and C mutual fund shares, and the sales charges and other expenses associated with each class of share. The script also included a discussion of which investors, with certain investment objectives, might generally find a particular share class of a mutual fund suitable for investment. The script made clear that Investment Services Advisors should consider the timing of mutual fund investments and convey to customers that "[t]he share that is right for you depends in large part on the period of time you intend to hold the shares and the amount of money you intend to invest."[9]

[cont'd]

generally do not convert to another class of shares, the typically higher operating expenses associated with them are ongoing and continue until the shares are sold.

7 Mutual fund investment managers generally permit no-cost or low cost exchanges of mutual fund shares within the family of funds they operate. Each class of shares is generally exchangeable for shares of the same class of another fund within the same family of funds. The exchanges often may be effected without paying any additional sales charges and, for Class B shares, without extending the holding period for calculating a CDSC or conversion benefits.

8 Although Epstein acknowledged that he received and read Merrill Lynch's compliance policies, in on-the-record testimony later given by Epstein to FINRA staff, Epstein disclaimed any knowledge of the firm's policies concerning mutual fund switch transactions.

9 Investment Services Advisors also had at their disposal guidance provided in the form of Merrill Lynch's Branch Office Policy Manual. This manual stated:

Share class recommendations are critically important . . . To determine which mutual fund share class may be the most appropriate for each investor, Financial Advisors should know the advantages and disadvantages of the different mutual fund classes and how they relate to the investor's stated investment goals and objectives, including the investor's time horizon . . . With a more complete description of share-class characteristics, investors will be better able to choose the share of class that is most suited to their investment needs.

Epstein's compensation consisted of a base salary of $35,000 plus variable compensation, which represented the primary opportunity for earnings growth.[10] Variable compensation consisted of commissions on annuitized and transactional business, and bonuses for meeting certain production hurdles, making targeted numbers of customer calls, bringing new money to existing customer accounts, and meeting certain professionalism standards. Investment Services Advisors were also encouraged to meet certain production hurdles for the sales of Merrill Lynch Investment Management ("MLIM") and other mutual funds through non-monetary sales contests. Merrill Lynch did not require that registered representatives promote MLIM funds to the exclusion of other fund families. The production credits that registered representatives received for the sale of MLIM funds were no larger than those received for the sale of mutual funds from any other fund family. Investment Services Advisors, however, did not receive production credits for mutual fund switch transactions that involved the exchange of shares within the same mutual fund family.

B. Epstein's Mutual Fund Switch Recommendations

Consistent with the allegations set forth in the complaint, we find that Epstein engaged in a pattern of recommending mutual fund switch transactions to 12 Merrill Lynch Financial Advisory Center customers from October 2001 through February 2002. Consistent with these recommendations, Epstein effected transactions whereby shares that the customers held in one or more mutual funds were sold and the sales proceeds were used to buy shares of another fund or funds from different fund families. From each of the switch transactions, Epstein earned compensation that he would not otherwise have enjoyed had the customer retained his or her initial investment or switched to a fund within the same family of funds as his initial mutual fund investment.

1. Customer TR

Customer TR was, at the time of the transactions at issue here, a 78-year-old retiree whose stated investment risk tolerance and objective were "conservative" and "growth," respectively. On October 15, 2001, Epstein made an unsolicited telephone call to TR to discuss his Merrill Lynch IRA account.[11] Epstein informed TR that his investment in the Merrill Lynch High Income Bond Fund was providing "a real nice yield" but had suffered losses of the principal invested. Epstein recommended that TR sell his investment in the Merrill Lynch fund and invest the sales proceeds in the Alliance U.S. Government Bond Fund. Stating "you all know more about that than I do," TR accepted Epstein's recommendation.

Epstein executed the following transactions for TR's account that settled on October 17, 2001:

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[10] From October 2001 to March 2002, Epstein earned total variable compensation of $26,443 and a salary of $17,499.

[11] Epstein indicated in Merrill Lynch's records that each of the transactions at issue in this matter had been "unsolicited." The preponderance of the evidence, however, establishes that each of the transactions in question occurred solely as a result of Epstein's prompting.

Sold $89,524 Merrill Lynch High Income Bond Fund Class B shares.
Bought $88,000 Alliance U.S. Government Bond Fund Class B shares.

Epstein did not discuss with TR the objectives, strategy, and risks of an investment in the Alliance fund, other than informing TR that the Alliance fund was "more stable" and "safer," and would continue to provide TR with income. Epstein also did not discuss with TR the different types of shares available for investment, or the sales charges and operating expenses associated with each share class and their effect on potential returns. Indeed, Epstein never disclosed to TR that he intended to purchase Class B shares in the Alliance fund with the proceeds from the sale of the Merrill Lynch fund Class B shares.

Epstein told TR that "it's not going to cost you at all to make the change." While TR had owned the Class B shares in the Merrill Lynch fund since 1993, long enough to avoid a CDSC upon their sale, Epstein did not inform TR that the Merrill Lynch shares would automatically convert to lower expensing Class D shares in less than two years.[12] Epstein also did not disclose that switching to the Alliance fund Class B shares would result in a new three-year CDSC holding period and an operating expense ratio more than double that associated with the Merrill Lynch fund Class B shares.[13]

Finally, Epstein did not discuss with TR the availability of a no-cost or low cost exchange of mutual fund shares. MLIM operated a mutual fund with an investment objective and portfolio similar to that of the Alliance U.S. Government Bond Fund. If TR had purchased Class B shares of the Merrill Lynch U.S. Government Mortgage Fund with the sales proceeds, TR could have done so without incurring a sales charge, without initiating or extending the CDSC holding period, and with the benefit of retaining the opportunity for a share conversion in less than two years.

2. <u>Customer DB</u>

Customer DB was, during the relevant period of time, an 81-year-old retired homemaker whose investment risk tolerance and objective were "conservative" and "income," respectively. On October 18, 2001, Epstein made an unsolicited telephone call intending to talk with DB. A man, later identified as DB's husband, answered the phone.[14] Epstein explained to him that he

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[12] MLIM mutual funds at the time offered Class D shares that were similar to Class A shares in their characteristics.

[13] The Alliance fund Class B shares would not convert to lower expensing Class A shares for six years.

[14] The man who answered the phone did not identify himself as DB's husband during his conversation with Epstein. Epstein did not ask for the man's name or his relationship to DB. At the time, DB's husband was an 82-year-old retired labor relations executive.

was calling to "review" DB's Merrill Lynch accounts.[15] DB's husband stated that DB was available, but that he was more knowledgeable about the accounts and that Epstein should therefore talk to him.

Epstein informed DB's husband that the yield on DB's investment in the Putnam New York Tax Exempt Income Fund was "down quite a bit" and that "what we'd like to do is move her into something that's going to provide her with a better tax free yield." Epstein recommended that DB switch to "a similar New York tax exempt bond fund and it's an – it's an Alliance fund versus this Putnam Fund." DB's husband asked Epstein "is there anything better?" Epstein explained that "we can go with government bonds and things like that, you know, that would . . . provide let's say 6, 7, 8, percent, but would be taxable" and reiterated that "the Alliance fund would provide us with a much better yield than the Putnam fund we're currently in." DB's husband stated "what we'd like you to do then is transfer to the Alliance account."

Epstein therefore executed the following transactions for DB's CMA trust account that settled on October 23, 2001:

Sold $93,892 Putnam New York Tax Exempt Income Fund Class A shares.
Bought $93,000 Alliance Municipal Income Fund New York Class C shares.

Epstein never identified for DB's husband the specific Alliance fund in which he intended to invest the proceeds from the sale of the Putnam fund shares. In recommending this transaction, Epstein informed DB's husband that there would "just be a one-year hold on the investment" and that there would be a "1 percent charge" if the shares were sold in the first year. Epstein, however, never specifically informed DB's husband that he intended to purchase Class C shares in the Alliance fund and never discussed with DB's husband the other mutual fund share classes available, the sales charges and expenses associated with them, or their effect on potential returns.

Epstein informed DB's husband that "there wouldn't be any cost to you" in undertaking the recommended switch between the two funds. Epstein, on the other hand, did not disclose that the switch, between funds with similar investment objectives and strategies, would result in more than a doubling of the operating expense ratio associated with DB's mutual fund investments. The higher expenses on the Class C Alliance fund shares, which did not enjoy any conversion privileges, would continue to be incurred for as long as DB held the shares. Epstein never discussed with DB's husband the effect of these higher expenses on potential returns.

Finally, Epstein did not discuss with DB's husband the tax consequences associated with the switch and failed to disclose that the sale of the Putnam Class A shares would result in a

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[15] DB had at Merrill Lynch both a "CMA" trust account and an IRA account. A CMA account, or cash management account, offers the features of a money-market fund and check-writing, as well as the ability to invest in equities, mutual funds, an other investment vehicles. There is no evidence that DB's husband was a trustee of DB's CMA trust account.

large capital gain tax liability for DB. DB incurred a tax liability of approximately $1,200 as a result of the switch. DB's husband stated that he would never have agreed to the switch if he had known about this tax liability.

3. Customer VB

In October 2001, Epstein made an unsolicited telephone call and spoke with customer VB. VB was a joint holder of a Merrill Lynch CMA account with EB, his wife, and CD. Epstein informed VB that he was calling "to go over some of the holdings that we have in the account." VB told Epstein that the account's investment objective was primarily to provide income for CD.[16]

Epstein noted that the account held "a couple of different high-income portfolios, the Franklin fund as well as the Merrill Lynch core bond fund." Referring to the Franklin fund, Epstein stated that "we've actually lost some money in that fund . . . [a]nd the yield on the fund has come down."[17] Epstein further stated that "that's an area we would like to see reinvested elsewhere where we're going to get a better yield and it's going to be a little more stable."

Explaining that "[h]igh yield is an area of the market that's . . . been a little beat up," Epstein recommended that VB switch some of the account's investments in certain high-yield mutual funds, including the Franklin fund and the "Merrill Lynch Bonds Fund High Income," into "safer . . . government bonds or government mortgage bonds, things that are going to be -- our principal is going to be a little bit more stable." Epstein recommended to VB "let's allocate some out of the high income . . . that way we get the money spread out a little better." "[W]e could take, let's say, half of each of the positions, you know half the Franklin, half the Lord Abbott, and half of the two Merrill Lynch high-income funds and allocate that all towards government safe, government issued bonds." Epstein explained that the proceeds from the sale of the shares in these funds should be invested in the Merrill Lynch Core Bond Fund "that's providing a good yield" and the PIMCO Real Return Bond Fund "that also invests in treasury notes and treasury bonds."

VB asked Epstein "what's the load?" Epstein replied, "[i]t's a lot safer . . . there wouldn't be any sort of a front-end sales load." Epstein explained that VB had the option of a "six-year hold" or a "one-year hold."

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16 The preponderance of the evidence shows that the investments in this account were primarily held for the benefit of customer CD, a retiree in her nineties. The information available to Epstein in Merrill Lynch's computer system indicated that the customer's investment risk tolerance and objective were "moderate" and "total return." No information concerning customers VB and EB was available to Epstein in Merrill Lynch's computer systems.

17 Contradicting himself, Epstein later stated that the investments in the high-yield funds had a "loss on principal; however, you know, in the interim, in the time you've held it, you know, we've earned a really nice yield."

On October 25, 2001, customer VB called Epstein to further discuss Epstein's recommendations. VB stated he wanted to "sell some of the Franklin." VB further stated that "number two is gonna be [selling] the Lord Abbott." VB and Epstein agreed to reinvest proceeds from the sale of shares in these funds in the PIMCO Real Return Bond Fund and the Merrill Lynch Core Bond Fund. VB expressed a desire to "go with" the "one-year hold" for the PIMCO fund and Esptein stated that "with the Merrill edition, we'll go ahead and add to the . . . fund we already have."

Epstein executed the following transactions for this joint account that settled on October 30, 2001:

Sold $18,000 Franklin Custodian Income Fund Class A shares.
Sold $11,274 Lord Abbott Bond Debenture Fund Class B shares.
Bought $5,000 Merrill Lynch Core Bond Fund Class B shares.
Bought $25,000 PIMCO Real Return Bond Fund Class C shares.

When selling the Lord Abbott shares to purchase shares in the new funds, VB's account incurred a $275 CDSC. Epstein informed VB that there would be a "one percent redemption fee" associated with the sale of the Lord Abbott shares during his first conversation with VB. Epstein did not inform VB, however, that the Lord Abbott Class B shares were within three years of their automatic conversion to lower expensing Class A shares.

Although Epstein stated that the expense ratio on the "six-year hold" was "about one percent" and the expense ratio on the "one-year hold" was "about one and a quarter percent," Epstein did not provide any further information concerning the expenses associated with the recommended switch transactions and their effect on potential returns. For example, the bulk of the funds for the purchase of the PIMCO Class C shares came from the sale of the Franklin fund Class A shares. The Franklin Class A shares had an operating expense ratio of .76 percent. By comparison, the PIMCO Class C shares had an operating expense ratio of 1.44 percent, nearly double that of the Franklin Class A shares. Further, because the PIMCO Class C shares did not convert into a lesser expensing class share, VB would be incurring higher expenses on these shares for as long as they were owned. Epstein did not disclose this fact to VB.

In recommending that VB reinvest some of the sales proceeds from the switch transactions in the Class B shares of the Merrill Lynch Core Bond Fund, shares of which VB already owned, Epstein stated that any future sales of these Class B shares would not incur "any costs." The Merrill Lynch Core Bond Fund Class B shares, however, were subject to a CDSC, although the time that the account previously held Class B shares in this fund would count when determining the holding period for calculating a CDSC at redemption. Epstein discussed with VB that he could "reallocate" to another Franklin fund or Merrill Lynch fund "at no charge," but he never broached the subject of a possible no-cost or low cost exchange within the Lord Abbott family of funds and never offered the names of any Franklin funds for VB to consider. Both the

Franklin and the Lord Abbott fund families had funds with comparable investment objectives to those purchased for VB's account on October 25, 2001.[18]

4. Customer GJJ

On October 31, 2001, customer GJJ, a 58-year-old widow whose stated investment risk tolerance and objective were "moderate" and "growth," contacted the Merrill Lynch Financial Advisory Center. Her telephone call was routed to Epstein. GJJ informed Epstein that she wished to withdraw $30,000 from either her Merrill Lynch CMA account or her IRA account. Epstein recommended that GJJ liquidate certain equity and mutual fund investments in her IRA account to raise funds for this withdrawal. Epstein also recommended that GJJ "reallocate" her investments in mutual funds to "maybe a growth fund and a value fund" to get the account a "little more balanced."

Epstein effected the following sales transactions in the accounts of GJJ that settled on November 1, 2001:

Sold $35,693 Elan Corp. PLC.
Sold $8,619 Alliance Technology Fund Class B shares.
Sold $20,750 Merrill Lynch Balanced Capital Fund Class B shares.

Epstein also effected the following purchase transactions that settled on November 2, 2001:

Bought $10,000 Oppenheimer Quest Balanced Value Fund Class B shares.
Bought $9,999 PIMCO Renaissance Fund Class B shares.

When speaking to Epstein, GJJ authorized the sale of approximately $45,000 of equity and mutual fund investments to provide for a net cash withdrawal of $30,000. Together, the proceeds from the sale of the Elan Corp. stock and the Alliance fund Class B shares approximated $45,000.

GJJ, however, never authorized any mutual fund switch transactions. Indeed, Epstein never mentioned the names of the mutual funds to which he was recommending that GJJ "reallocate" her investments, the different class of shares associated with these funds, or the charges and expenses associated with the universe of shares available for investment and their effect on potential returns.

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18 The purported rationale for Epstein's switch recommendation to VB was that VB's investments in the high-yield Franklin and Lord Abbott funds were losing money and had suffered a decline in their current yields. At the time of the switch transactions that were undertaken as a result of Epstein's recommendation, the Franklin fund and Lord Abbott fund shares were enjoying current yields of 8.21 percent and 7.78 percent, respectively. The shares purchased in the Merrill Lynch and PIMCO funds with sales proceeds, however, were only enjoying current yields of 4.17 percent and .75 percent, respectively. These facts were not disclosed by Epstein to VB.

Although GJJ did not incur a CDSC on the sale of the Merrill Lynch fund Class B shares, those Class B shares would have converted to Class D shares, with a significantly lower operating expense ratio, in approximately two and one-half years. Instead, by purchasing Class B shares in the Oppenheimer and PIMCO funds, Epstein subjected GJJ to new six-year CDSC holding periods and a potentially longer period of relatively higher operating expenses.[19] At no time did Epstein discuss with GJJ the possibility of a more cost effective switch into another fund within the Merrill Lynch family of funds.

5. Customer RR

In late October 2001, customer RR called the Financial Advisory Center concerning her Merrill Lynch accounts. At the time, RR was a 75-year-old retiree whose stated investment risk tolerance and objective were "moderate" and "total return" for her CMA account, and "conservative" and "income" for her IRA account. RR's telephone call was routed to Epstein. RR asked Epstein for the balance in the money market component of her CMA account and stated that she wanted to withdraw $300. After addressing RR's inquiry, Epstein asked RR whether she "[w]ould like to review the accounts that you have here with us now while you have a consultant on the line?" RR replied that she would.

Epstein commented that "[i]t looks like we got a couple of municipal bond funds" in the CMA account. Epstein asked RR "[a]re you looking mainly to generate income?" RR responded "yeah." Epstein explained that "[o]ne of the funds that you have, your Eaton Vance Fund, the rate of interest that you're earning on the fund is come down quite a bit as interest rates have come down . . . what I would recommend for that fund is moving that into something that is going to provide you with a higher tax free yield." Epstein stated that "[w]hat I would like to see done with that fund is moved into a different Virginia bond fund that's going to provide you with a little bit more income."

Later, while still reviewing RR's CMA account, Epstein also recommended taking a portion of the balance in the money market component of this account and "add that to, you know, one of your tax free investments. We can add it to your Virginia Bond Fund or even your national bond fund. . . . That way it's working a little harder for you." Epstein recommended to RR that he would "take $10,000 of that [money market] position and also go ahead and move that into the bonds for you."

Epstein also explained to RR that he wanted to discuss her Merrill Lynch IRA account with her. Epstein stated that "you have all your money tied up in the money market right now." He further stated that "[w]hat I would recommend doing in this account is moving the money into some government bonds in something that is going to provide you with a higher yield . . . . You know, what I can do is invest, let's say, $12,000 in the government bonds for you."

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19 The switching of a portion of the sales proceeds from the Merrill Lynch fund to the Oppenheimer fund was a switch between two funds with similar investment objectives and portfolios.

Summarizing his recommendations concerning both RR's CMA account and IRA account, Epstein explained to RR "we're going to change the Eaton Vance. We're also going to go ahead and take $10,000 out of the money market account and add that to the National Bond Fund that you have, the Merrill Lynch fund and then in the retirement account, we're going to take $12,000 and invest that in government bonds for you."[20] RR, who states that she is hard of hearing and didn't know what Epstein was saying, responded "Okay."

Epstein executed the following series of transactions in RR's CMA and IRA accounts that settled on November 5, 2001:

(CMA account)

Sold $21,615 Eaton Vance Virginia Municipals Fund Class B shares.
Redeemed $9,385 from Money-Market Account.
Bought $21,000 Alliance Municipal Income Fund II, Virginia Portfolio, Class B shares.
Bought $10,000 Merrill Lynch Municipal Bond National Fund Class B shares.

(IRA account)

Redeemed $12,000 from Money Market Account.
Bought $12,000 Merrill Lynch Core Bond Fund Class B shares.

Epstein never informed RR of the name of the Virginia bond fund in which he intended to invest the proceeds from the sale of the Eaton Vance fund shares. Further, Epstein informed RR that he intended to invest $12,000 in "government bonds." Epstein instead purchased shares in the Merrill Lynch Core Bond fund. Epstein never discussed this fund with RR, never disclosed his intention to purchase shares of this fund for her account, and never explained to RR the fund's investment objectives and portfolio.

Epstein also never discussed with RR the share class options available for investment in the Alliance fund or either of the Merrill Lynch funds, or the charges and expenses associated with the different classes of shares available and their effect on potential returns. By switching from the Eaton Vance fund to the Alliance fund, RR was switched to a fund with a similar investment objective and portfolio. In recommending that RR sell her Class B shares in the Eaton Vance fund, however, Epstein never informed RR that these shares would automatically convert to lower expensing Class A shares within two years, which would have improved the total return on her investment. By purchasing the Class B Alliance and Merrill Lynch fund shares, RR instead triggered new CDSC holding periods, a fact that Epstein also failed to disclose to RR. These shares would not be eligible for conversion to a class of shares with lower operating expenses for several years.

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[20] At the time, RR owned Class A shares in the Merrill Lynch Bond National Fund.

Unhappy with the way Epstein had handled her account, RR closed her accounts at Merrill Lynch and transferred her account funds to another broker-dealer. In doing so, RR unknowingly incurred $877.88 in deferred sales charges.

6. Customer HM

On November 1, 2001, Epstein made an unsolicited telephone call to customer HM to review his account holdings. Epstein asked HM, “is our goal still just to preserve the capital and make a little bit of income?”[21] HM replied that it was.

Epstein informed HM that the yield on “your Franklin Federal Tax Exempt Fund . . . has come down quite a bit.” Epstein recommended that HM switch her investment in the Franklin fund to the Nuveen Colorado Municipal Bond Fund. Epstein stated the Nuveen fund was “a triple tax exempt fund . . . and it would provide you with a higher yield than what we’re currently earning now.”[22]

HM queried whether “it would cost something” to switch funds and wondered if a switch “would be enough to be worth it.” Epstein explained “there’s a couple different ways . . . you can go about making the change.” Epstein stated one would involve paying an “upfront sales charge.” Epstein also stated that “if we didn’t feel comfortable doing that . . . we can go with a share class . . . [where] there would simply be a holding period on the fund” of either four years or one year. HM replied that “I think I’d just like to leave it.” Epstein then recommended a “one-year hold,” implying a Class C share investment, “that way, you can, in fact, go ahead and get a better triple tax exempt yield” and “there wouldn’t be any sort of costs associated with it.” With HM still unsure, Epstein repeated his recommendation several times, until HM relented and stated “you go ahead and you do that.”

Epstein executed the following transactions in the account of HM that settled on November 6, 2001:

Sold $47,296 Franklin Federal Tax Free Income Class A shares.
Bought $47,000 Nuveen Colorado Municipal Bond Fund Class C shares.

Epstein never discussed the operating expenses associated with the Nuveen fund shares, their comparison to other available classes of shares, or the effect of operating expenses on potential returns. Epstein failed to disclose that the operating expenses associated with the Nuveen shares were more than double those associated with the Franklin Class A shares and that the Class C shares, which had no conversion privileges, would experience these higher operating expenses for as long as HM chose not to sell them. Epstein also never discussed with HM the

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21 HM, whose age is unknown, stated that her investment risk tolerance and objective were “moderate” and “total return,” respectively.

22 This statement was incorrect. The yield on the Franklin fund that Epstein recommended HM liquidate was still higher than the yield on the Nuveen fund that he was recommending that HM purchase.

option of switching into a Franklin family fund that was comparable to the Nuveen fund, namely the Franklin Colorado Tax Free Fund, which would have allowed HM to avoid the one-year, one percent CDSC associated with the Nuveen fund investment.

7. Customer SA

On November 6, 2001, Epstein made an unsolicited telephone call to customer SA to "touch base and go over some of the holdings that you have in your account." SA was at the time a 75-year-old retired FBI agent whose account was jointly held with his wife, MA. Their stated investment risk tolerance and objective were "moderate" and "income," respectively.

Epstein informed SA that two municipal investment trust investments in his Merrill Lynch account were maturing. Epstein stated that "what we're looking to do is . . . get clients that are in these [municipal trust] investments and . . . get them reallocated as best as we can."

Epstein asked SA "are you looking to continue to generate, you know, tax exempt interest from this account?" SA replied "I'd like to." Epstein informed SA "we have a couple of options." "[W]e can go triple tax exempt, you know, Virginia State Fund," or "you can go with a national bond fund . . . similar to the Eaton Vance Fund where you're getting . . . a little bit of a higher return."[23] Epstein informed SA "I think that adding the Eaton Vance position . . . would be the best thing to continue to get tax free income for you." After SA stated he was "not crazy about that upfront charge," Esptein suggested a "one-year hold investment," "a class 'C' share class." SA stated "I think we can do that."

Epstein also explained to SA that "you have the Merrill Lynch Balanced Capital Fund . . . which is a fund which really hasn't been performing that well." Epstein stated that "what I'd like to do is move – move it into a different balance fund for you." Epstein stated that "we can go with the one where you have one-year hold on it" but "[i]t's got a better track record and should hopefully continue to perform a little better." SA simply replied "Okay."

Epstein effected the following transactions for the account of SA that settled on November 9, 2001:

Sold $31,290 Municipal Investment Trust.
Sold $29,627 Municipal Investment Trust.
Bought $60,000 Eaton Vance High Yield Municipals Fund Class C shares.

Sold $39,738 Merrill Lynch Balanced Capital Fund Class D shares.
Bought $38,000 Oppenheimer Quest Balanced Value Fund Class C shares.

In making his recommendations to SA, Epstein never informed SA that the fund in which he intended to reinvest the proceeds from the sale of the Merrill Lynch fund shares was the

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23 At the time, SA and MA held Class A shares in the Eaton Vance High Yield Municipals Fund.

Oppenheimer Quest Balanced Value Fund. Furthermore, although Epstein recommended the purchase of Class C shares for both the Eaton Vance and Oppenheimer funds, and informed SA that they were subject to a CDSC, Epstein never discussed with SA the operating expense ratios involved with each class of shares available for investment and their effect on potential returns. Esptein did not inform SA that the Oppenheimer fund Class C shares would result in SA paying substantially higher operating expenses for a fund with an investment objective and portfolio similar to that of the Merrill Lynch fund. The Oppenheimer fund Class C shares had an operating expense ratio of 2.06 percent, while the Merrill Lynch Class D shares had an operating expense ratio of just .84 percent. Epstein also never disclosed that the Class C shares purchased were not convertible to a less expensive class of shares and that SA would continue to pay higher operating expenses on these shares until they were sold.

8. Customer WF

In early January 2002, Epstein made an unsolicited call to customer WF to discuss the joint account held in his name and in the name of his mother, SF. Epstein stated that "[t]he reason for our phone call today, the investment that you have in your account, your Alliance North American Fund – there's actually been a lot going on with this fund." Epstein stated the "fund had a large stake in . . . Argentina's debt" and "[w]hat they're actually doing is they're cutting their dividend or their yield by one – one full percentage point."

Epstein asked WF, "what exactly are we looking for with the particular account?" WF stated "it's really my mom's account" and that "what she's doing simply is taking the interest off of [sic] monthly and just using it in her retirement."[24]

Epstein explained that "[w]e'd like to continue that for her, but – you know, a little more conservatively." Epstein recommended that WF consider "a combination of higher yielding bonds . . . and also some higher quality bonds" to replace the investment in the Alliance fund. Epstein stated "I think it will be a little bit safer that way." WF asked that Epstein call him back after WF had an opportunity to discuss Epstein's recommendations with SF.

Epstein called WF on January 8, 2002. WF informed Epstein that "I talked to my mom and she said that was fine. To go ahead and move it." Epstein stated "Okay. I'm going to go ahead and take care of that."

Epstein effected the following transactions for the account that settled on January 10, 2002:

Sold $44,863 Alliance North American Government Income Class A shares.
Bought $22,000 Merrill Lynch U.S. Government Mortgage Fund Class B shares.
Bought $22,000 Merrill Lynch High Income Bond Fund Class B shares.

24 The records available to Epstein provided no information concerning WF's or SF's age, occupation, financial needs, or experience. The stated investment risk tolerance and objective for the account were "moderate" and "total return," respectively.

Epstein never identified for WF the "bonds" that he intended to purchase and failed to disclose to WF that, in actuality, he intended to purchase shares in Merrill Lynch bond mutual funds. Epstein also did not discuss with WF the different types of fund share classes available for investment, or the charges and operating expenses associated with each fund share and their effect on potential returns.

Epstein failed to inform WF that by switching from the Alliance Class A shares to the Merrill Lynch Class B shares, WF would be incurring a four-year CDSC holding period and that the Class B shares would not convert to a less expensive class of shares for 10 years. Epstein also did not disclose to WF the possibility of an exchange for Class A shares of another Alliance family fund, such as the Alliance U.S. Government Bond Fund that he had recently recommended to customer TR. Finally, Epstein switched a portion of the sales proceeds from the Alliance fund to the Merrill Lynch High Income Bond Fund, despite informing customer TR less than three months earlier that this fund was performing poorly and was less "safe" and less "stable" than the Alliance U.S. Government Bond Fund.

9. Customer KW

On January 8, 2002, Epstein made an unsolicited telephone call to customer KW, a 74-year-old man with no known employment whose investment risk tolerance and objective were "moderate" and "total return," respectively. Epstein explained to KW that he "wanted to go over the investment that you have in your account."

Epstein stated that KW's investment in the Alliance North American Government Income Fund had "come under quite a bit of fire lately." Epstein informed KW that "there's been a full percentage point drop in the payout, or the interest, that you've been earning each month." Epstein recommended that KW switch to a "combination of a high yield fund and also a government mortgage fund."

KW explained that he was concerned about paying taxes on the sale of his investment in the Alliance fund. Epstein explained that KW "could go into a New Jersey municipal bond fund where you're going to get 3 ½ percent, 4 percent, tax free." After Epstein reiterated his original recommendation several more times, RG stated "I want the tax free." Epstein stated "I'll go ahead and move it into the New Jersey tax frees." Epstein stated that he would put KW in Class C shares with a "one-year hold" and a "one percent redemption fee."

Epstein effected the following transactions that settled in KW's account on January 10, 2002:

Sold $21,842 Alliance North American Government Income Fund Class A shares.
Bought $20,000 Merrill Lynch New Jersey Bond Fund Class C shares.

Epstein did not disclose to KW the name of the New Jersey municipal bond fund to which he intended to invest the proceeds from the sale of shares in the Alliance fund. Epstein also did not discuss with KW the classes of shares other than Class C shares, and their associated charges and expenses, available for investment.

Epstein also recommended this switch without discussing with KW the option of a cost-free switch to the Alliance New Jersey Municipal Fund, a fund with a similar investment objective and portfolio to the Merrill Lynch fund. While the Merrill Lynch fund Class C shares had an annual operating expense ratio that was about one-half percentage point lower then the Alliance North American Government Income Fund Class A shares, a switch to Class A shares of the Alliance New Jersey Municipal Fund would have lowered those annual expenses by three-quarters of one percent and would not have triggered a CDSC holding period. Epstein never shared any of this information with KW.

10. Customer RG

On January 10, 2002, Epstein made an unsolicited call to customer RG, a 71-year-old retiree whose investment risk tolerance and objective were "moderate" and "growth," respectively. Epstein called to inform RG that a $10,000 certificate of deposit held in his Merrill Lynch IRA account was due to mature on January 14, 2002. Epstein discussed using the proceeds from the certificate of deposit to invest in a government bond fund. RG stated "[t]hat sounds good."

Epstein also discussed with RG his holdings in the Merrill Lynch Balanced Capital Fund. Epstein explained that the Merrill Lynch fund was not doing well and he suggested instead that RG invest in the Oppenheimer "Quest for Balance Fund," which Epstein explained "had a nice track record" and "would do a little better."

Epstein explained "what we can do is go ahead and switch the balance funds for you, take what's in the CD – the $10,000 CD – and then go ahead and redeem that into the government bonds for you today as well." RG responded "Okay."

On January 14, 2002, the $10,000 certificate of deposit was redeemed. Epstein then effected the following transactions that settled in RG's account on January 15, 2002:

Sold $43,336 Merrill Lynch Balanced Capital Fund Class B shares.
Bought $25,000 Franklin US Government Securities Fund Class B shares.
Bought $28,000 Oppenheimer Quest Balanced Value Fund Class B shares.

Epstein never identified for RG the name of the government bond fund, in this case the Franklin U.S. Government Securities Fund, in which he intended to invest the proceeds from the maturing CD. Epstein also never discussed with RG taking a portion of the proceeds from the sale of the Merrill Lynch fund shares to invest in the Franklin fund.

RG incurred a CDSC of $665.84 as a result of the sale of the Merrill Lynch fund's Class B shares. Epstein did not disclose to RG that he would incur this charge partly for a switch between two funds with similar investment objectives and portfolios.

Epstein also never discussed with RG the different classes of shares available for investment in either the Franklin fund or the Oppenheimer fund, or the charges and expenses associated with each class of shares and their effect on potential returns. Indeed, Epstein did not disclose the fact that he intended to purchase Class B shares in the Franklin and Oppenheimer funds, which would result in RG triggering new CDSC holding periods of six years for both funds. If RG had held the Class B shares in the Merrill Lynch fund for just a few more weeks, they would have automatically converted to Class D shares, thereby cutting the operating expense ratio associated with his investment from 1.61 percent to .84 percent. Instead, with the Oppenheimer fund Class B shares, RG incurred an operating expense ratio of 2.06 percent. Epstein did not disclose these facts to RG.

11. Customer DP

On February 6, 2002, customer DP telephoned the Financial Advisory Center to inquire about a $40 service fee associated with three custodial accounts that DP, a 75-year-old retired widow, held at Merrill Lynch for her great-grandchildren, who were between the ages of five and seven. DP's call was routed to Epstein.

After addressing DP's questions about the service fees, Epstein noted that DP held shares in the Merrill Lynch Balanced Capital Fund in each of the three custodial accounts. Epstein stated "[t]hat's a fund that hasn't really done particularly well for us."

DP explained that she was using the accounts to invest long-term for the college educations of her great-grandchildren. Epstein stated "[w]hat I'd like to do is move it into a different fund going with an – with an Oppenheimer Balance Fund . . . that's done a little bit better." Epstein informed DP that "it's not going to cost us anything to make the changes." DP replied, "Okay."

Epstein effected the following transactions in each of the three accounts that DP held for her great-grandchildren that settled in each account on February 11 and 12, 2002:

> Sold (approximately) $10,720 Merrill Lynch Balanced Capital Fund Class B shares.
> Bought (approximately) $10,720 Oppenheimer Quest Balanced Value Fund Class B shares.

In recommending these switch transactions, Epstein never discussed with DP the different class shares available for investment, or the charges and operating expenses associated with each class of shares and their effect on potential returns. For example, Epstein did not disclose to DP that the Merrill Lynch Class B shares, which had been purchased for each of the custodial accounts in 1997, would automatically convert to lower expensing Class D shares in approximately three years. Epstein also never informed DP that the Oppenheimer fund Class B shares would result in DP paying higher operating expenses for a fund with an investment objective and portfolio similar to that of the Merrill Lynch fund. The operating expense ratio of the Oppenheimer fund Class B shares was 45 basis points higher than that of the Merrill Lynch Class B shares. Finally, Epstein did not discuss with DP whether, because she intended to hold her investments for approximately 10 years or more, whether investing in Class A shares, and paying an up-front sales charge but lower operating expenses, would offset the higher expenses associated with the Oppenheimer Class B shares.

By investing in Class B shares of the Oppenheimer fund, DP incurred a new six-year CDSC holding period in each account, a fact that Epstein never disclosed to her. Indeed, when the Oppenheimer fund investment recommended by Epstein performed poorly, DP decided to sell the Class B shares purchased and incurred a CDSC for each account.

12. Customer VW

In late February 2002, customer VW, a retired widow, contacted the Financial Advisory Center to inquire about transferring the securities held in an account at another broker-dealer to an account she held at Merrill Lynch. Her call was directed to Epstein.

After addressing VW's questions, Epstein asked VW if he could review with her the holdings in her existing Merrill Lynch account. VW said he could. Epstein then asked VW "what exactly are – are the goals right now at this particular point in time with the account?" VW responded "I'm just here for a long haul."[25]

Epstein commented that some of the funds in VW's account were held in the Merrill Lynch Balanced Capital Fund. Epstein stated that this fund "hasn't done particularly well for us." He then explained that "what I would recommend doing if you're in it for the long haul and looking for a little bit of growth would be to – to move that into a different balance fund for you." He stated that "what we would be looking to move that into is called the Oppenheimer Quest For Value Fund." Epstein informed VW that "we can do so at – at no cost to you" and recommended that VW, who had stated her investment goals were long-term, "move it into a Class C share class where you don't pay anything upfront . . . and there's only a one-year hold on the investment." "[S]o, you know, it would be for the short term if you need to sell."

VW asked Epstein if he could call her back in a few days so that she could consider Epstein's recommendation. On February 20, 2002, Epstein called VW. VW informed Epstein that she wished to make the switch from the Merrill Lynch fund to the Oppenheimer fund as Epstein had recommended. Epstein stated "[t]hen I'll go ahead and take care of that."

Epstein effected the following transactions that settled in VW's account on February 25, 2002:

Sold $27,618 Merrill Lynch Balanced Capital Fund Class B shares.
Bought $26,500 Oppenheimer Quest Balanced Value Fund Class C shares.

Epstein did not disclose to VW that the Merrill Lynch Class B shares, which had been purchased beginning in 1996, would convert to lower expensing Class D shares in approximately two years. In recommending the switches, Epstein also never discussed with VW the classes of shares, other than Class C shares, available for investment, or the charges and operating expenses associated with each different class of shares and their effect on potential returns. Although Epstein informed VW that the switch would be "at no cost," Epstein did not disclose that the

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25 VW's opening account documents, completed in 1991, indicated that her investment risk tolerance and objective were "good quality" and "income," respectively.

Oppenheimer fund Class C shares would result in VW paying higher operating expenses for a fund with an investment objective and portfolio similar to that of the Merrill Lynch fund or that VW would continue to pay those higher expenses for the life of the Class C share investment. The operating expense ratio of the Oppenheimer fund Class C shares was 45 basis points higher than that of the Merrill Lynch Class B shares. At the time, Class D shares in the Merrill Lynch fund had an operating expense ratio of .84 percent.

III. Discussion

We affirm the Hearing Panel's findings that Epstein made unsuitable mutual fund switch recommendations to 12 customers in violation of NASD rules. For the reasons discussed below, we decline to consider the allegations set forth in Enforcement's complaint that Epstein's recommendations were accompanied by misrepresentations and omissions of material facts. In reaching these conclusions, we reject as without merit Epstein's arguments on appeal.

A. Epstein Made Unsuitable Mutual Fund Switch Recommendations

NASD Rule 2310(a) requires that a registered representative, before recommending the purchase, sale, or exchange of any security, "have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customers as to his other security holdings and financial situation and needs." NASD Rule 2310(b) further requires a registered representative to undertake, prior to executing a recommended transaction, reasonable efforts to obtain information concerning the customer's financial status, investment objectives, and any other information considered reasonable in making recommendations to customers. We find that Epstein violated these suitability requirements when he recommended the mutual fund switch transactions at issue in this case.[26]

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[26] The suitability rule applies only to securities that a broker "recommends" to customers. *Dep't of Enforcement v. Chase*, Complaint No. C8A990081, 2001 NASD Discip. LEXIS 30, at *15 (NASD NAC Aug. 15, 2001), *aff'd*, Exchange Act Rel. No. 47476, 2003 SEC LEXIS 566 (Mar. 10, 2003). As FINRA has emphasized, whether a "communication . . . constitutes a 'recommendation' remains a 'facts and circumstances' inquiry to be conducted on a case-by-case basis." *NASD Notice to Members 01-23* (Apr. 2001). FINRA has articulated several principles that guide the analysis of whether a particular communication should be deemed a recommendation. For example, the content, context, and manner in which information is presented to a customer are of particular significance. *Id*. Moreover, the determination of whether a "recommendation" has been made is an objective, rather than a subjective, inquiry. *Id*. In this regard, an important consideration is whether the communication—given its content, context, and manner of presentation—reasonably would be viewed as a "call to action" or a suggestion that the customer engage in a particular transaction. *Id*. The degree to which a communication reasonably "would influence an investor to trade a particular security or group of securities" may be considered in analyzing whether a communication is a "recommendation." *Id*. Furthermore, "a series of actions which may not constitute 'recommendations' when considered individually, may amount to a 'recommendation' when considered in the aggregate." *Id*. With these principles in mind, we find that Epstein recommended each of the mutual fund switch transactions that are the subject of this case.

First, a registered representative must make a "customer-specific determination of suitability" and tailor his or her recommendations "to the customer's financial profile and investment objectives." *F.J. Kaufman & Co.*, 50 S.E.C. 164, 168 (1989). To determine whether, in recommending the purchase or sale of a mutual fund to a customer, a registered representative has disclosed all material facts, he or she must attempt to obtain information sufficient to assess the suitability of a recommended investment for the customer. *NASD Notice to Members 94-16* (Mar. 1994). The starting point in a registered representative's recommendation concerning mutual fund investments is "to clearly define the investor's objectives and financial situation," considering the customer's current income, liquidity, diversification, and acceptable levels of risk. *NASD Notice to Members 95-80* (Sept. 1995). Registered representatives should ask a customer considering a mutual fund investment "what are his or her investment goals and objectives, including the investor's time horizon." "Suitability Issues for Multi-Class Mutual Funds," *NASD Regulatory and Compliance Alert* (Summer 2000).

Epstein did not have a prior or existing relationship with each of the customers to whom he recommended the switch transactions that are the subject of Enforcement's complaint. Because the Financial Advisory Center customer accounts had been transferred from Merrill Lynch branch offices, the written account documentation accompanying these accounts was generally unavailable to the Investment Services Advisors. They instead had at their disposal a Merrill Lynch computer system that provided information concerning Financial Advisory Center customers. Although these computer files contained some customer information, it was generally not current and often provided little information concerning the customer's financial status, investment objectives, or other information necessary for making a suitable recommendation. Merrill Lynch therefore required its Investment Services Advisors to review and verify all customer information in Merrill Lynch's records, including a customer's investment experience, investment objective, and risk tolerance.

In on-the-record testimony given to FINRA staff, and in other documentation completed by Epstein when effecting the transactions at issue, Epstein stated that he reviewed each customer's account information and updated Merrill Lynch's records when appropriate. Epstein stated that he would review with each customer the customer's age, investment objective and goals, risk tolerance, and overall financial information. Based upon this acquired information, Epstein claims he would discuss with the customer the mutual fund investment options available and make a specific recommendation to the customer.

The tape recordings and transcripts of Epstein's conversations with the 12 customers whose accounts are at issue here, however, belie Epstein's testimony.[27] There is no evidence that Epstein ever considered the overall financial situation, level of investment experience, sophistication, or financial needs of the customers. Other than an occasional, generic question concerning a customer's desire to "generate income" or "goals," we find that Epstein did not fulfill his duty to undertake reasonable efforts to obtain information necessary for him to make

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[27] Merrill Lynch also required that Investment Services Advisors maintain notes in the firm's computer systems summarizing each conversation with a customer. Epstein did not, however, maintain any notes of his conversations with the customers concerning the transactions that are at issue in this case.

suitable recommendations. Indeed, we can discern no evidence that Epstein ever attempted to determine whether a customer had changed his or her investment objective or risk tolerance such that the switch recommendations he routinely made were suitable. *See Winston H. Kinderdick*, 46 S.E.C. 636, 638-39 (1976) (finding mutual fund switch transactions unsuitable where there was no apparent change in the customer's investment objective, financial situation, or needs at the time of the transaction). Epstein made few, if any, suitability inquiries, much less the customer-specific determinations that are required under NASD Rule 2310. This is particularly troubling given the fact that the customers with whom he dealt were generally elderly, retired, and unsophisticated. *See NASD Notice to Members 94-16* ("Members selling funds to elderly, retired, or first-time investors must have an adequate and reasonable basis for selling a particular fund to the investor.")

Second, recommendations must be consistent with a customer's best interests.[28] *Faber*, 2004 SEC LEXIS 277, at *23-24. In recommending mutual funds, a registered representative should match a customer's objective with the stated objective and investment strategy of a particular fund. *NASD Notice to Members 95-80*. For multi-class mutual funds, a registered representative must provide sufficient information for a customer to understand and evaluate a fund's multi-class structure and recommend to the customer a class of shares whose fee structure best fits the customer's needs.[29] *Id*.

Mutual fund switches "may be difficult to justify if the financial gain or investment objective to be achieved by the switch is undermined by the transactions fees associated with the switch." *NASD Notice to Members 95-80*. Thus, a registered representative "must evaluate the net investment advantage of any recommended switch from one fund to another" and must be able to demonstrate the rationale for the recommendation based upon the information obtained from the customer for the purpose of making a suitability determination. *NASD Notice to Members 94-16*. "A pattern of switches from one fund to another by several customers of a registered representative, where there is no indication of a change in the investment objectives of the customers and where new sales loads are incurred, is not reconcilable with the concept of suitability." *Kinderdick*, 46 S.E.C. at 639. Where such a pattern is established, it is incumbent upon the registered representative that recommended such switches to demonstrate the unusual circumstances which justified what is a clear departure from the manner in which mutual fund

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[28] "A recommendation is not suitable merely because the customer acquiesces in the recommendation. Rather, the recommendation must be consistent with the customer's financial situation and needs." *Dane S. Faber*, Exchange Act Rel. No. 49216, 2004 SEC LEXIS 277, at *24 (Feb. 10, 2004).

[29] FINRA members and their associated persons should ensure "that prospective investors understand the nature of the various charges made by mutual funds to defray sales and sales promotion expenses, whether they are deducted from an investor's purchase payment, charged on redemption, or levied against the net assets of a fund." *NASD Notice to Members 89-35* (Apr. 1989). In this regard, it is important to explain how factors such as the amount invested in a fund, the amount of time the investor remains in the fund, and a fund's conversion features affect an investor's overall costs and returns. *See NASD Notice to Members 94-16; NASD Notice to Members 95-80*.

investments are normally made. *Kenneth C. Krull*, 53 S.E.C. 1101, 1104-05 (1998), *aff'd*, 248 F.3d 907 (9th Cir. 2001).

We find that the preponderance of the evidence in this case indicates the existence of a pattern of switches from one fund to another that were recommended by Epstein to the Financial Advisory Center customers with whom he dealt. We also find that Epstein failed to introduce any evidence showing that he had any reasonable grounds to believe that his recommendations to switch from one fund to another were suitable. Rather, the preponderance of the evidence establishes that Epstein routinely recommended switch transactions that caused customers to incur sales charges, triggered new and lengthy CDSC holding periods, and burdened customers with higher fund expenses.[30] Often, there was no discernible advantage gained from a switch to a new fund and there was no indication of a change in the investment objectives of the customers. For these reasons, and in light of Epstein's failure to discuss with customers the availability of funds without sales charges within the same fund family as the customers' initial mutual fund investments, the mutual fund switch transactions recommended by Epstein were unsuitable. *See Dep't of Enforcement v. Belden*, Complaint No. C05010012, 2002 NASD Discip. LEXIS 12, at *15 (NASD NAC Aug. 13, 2002) ("[A] registered representative violated the suitability rule when he recommended the purchase of mutual fund shares without having reasonable grounds for believing that such transactions were suitable for the customer in light of the customer's ability to purchase funds with similar investment objectives within the mutual fund families without incurring a sales charge."), *aff'd*, Exchange Act Rel. No. 47859, 2003 SEC LEXIS 1154 (May 14, 2003).

FINRA has long held that a registered representative "has an obligation to avoid increasing the costs that his or her customers pay." *Id.* at *14-15. Epstein failed to abide by this obligation. Without a complete description of the different share classes available for investment, the charges and expenses associated with each, and the potential effect on investment return, Epstein's customers were unable to determine that a switch was suited to their needs. *See* "Suitability Issues for Multi-Class Mutual Funds," *NASD Regulatory and Compliance Alert* ("With a more complete description of share-class characteristics, investors will be better able to choose the class that is most suited to their investment needs"); *see also Chase*, 2003 SEC LEXIS 566, at *18 ("Mere disclosure of risks is not enough. A registered representative must be satisfied that the customer fully understands the risk involved.") (internal quotations omitted).

We are left with the conclusion that Epstein put his own interests before those of his customers. As a result of his switch recommendations, Epstein received significantly higher compensation than he would have otherwise received. *See Krull*, 53 S.E.C. at 1110-11 (finding the respondent "ignored his fundamental obligation of fair dealing by . . . plac[ing] his own

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[30] We thus find Epstein's oft invoked refrain that a particular mutual fund switch transaction would involve "no cost" troubling. *See NASD Notice to Members 89-35*. Even for a customer that expresses a desire to avoid an initial sales charge, it is incumbent upon the registered representative to inform the customer of the potential long-term effect of higher ongoing asset based sales charges associated with the classes of shares recommended. "Suitability Issues for Multi-Class Mutual Funds," *NASD Regulatory and Compliance Alert*.

interest in garnering commissions above those of his customers"); *see also NASD Notice to Members 95-80* ("Members must not recommend that a customer switch from one mutual fund to another based on the compensation that the member or its associated persons will receive from effecting the switch."). A review of the taped recordings and transcripts of Epstein's conversations with his customers shows that he routinely recommended unjustified switches between funds to chase what he claimed, sometimes erroneously, to be higher yields.[31] By his own admission, however, Epstein had no other bases for his recommendations and never considered or discussed with the Financial Advisory Center customers the long-term effect of sales charges and expenses on the recommended mutual fund transactions.[32] *Cf. Dep't of Enforcement v. Respondent*, Complaint No. C07010037, 2003 NASD Discip. LEXIS 16, at *28-29 (NASD NAC May 13, 2003) (finding, in a dismissal of suitability allegations, that "the record shows that Respondent discussed with his clients the effect that the sales charges would have, and his opinion that those charges would be more than offset by the gains that would occur in their accounts from the switches"); *see also Irish*, 42 S.E.C. at 740 ("While an occasional switch from a fund of one type to that of another might have been justified in a particular situation, the volume of switching experienced in this case cannot be explained on the basis of the considerations advanced by registrant."). Indeed, any attempt to justify Epstein's recommendations can hardly be convincing when he was recommending the sale of a particular fund, or fund type, to one customer and shortly thereafter recommended the purchase of the same fund, or fund type, to another. *See Krull*, 248 F.3d at 913.

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[31] Because mutual funds are long-term investments, the historical performance of the funds involved in a switch transaction should be discussed with a customer. *See NASD Notice to Members 94-16*. Customers must also be given information so that they understand the concepts of total return, which measures the overall performance of a mutual fund, and current yield, which is based only on interest or dividend income received by the fund. *NASD Notice to Members 95-80*. We find that Epstein's regular practice of highlighting short-term disruptions in the performance of particular funds to justify a switch fell short of these standards, especially in those cases in which Epstein was recommending a switch between funds with similar investment objectives and portfolios. For example, in recommending to DB's husband a switch between the Putnam New York Tax Exempt Income Fund and the Appliance Municipal Income Fund New York, Epstein stated that the Putnam fund was "right now only yielding about 3 percent tax free" and that yield on the unnamed Alliance fund was "a full percentage point better" than the Putnam fund. The yield on the Putnam fund for the quarter ending September 2001, however, was 4.05 percent. The total returns enjoyed by the two funds over a period of five years preceeding Epstein's recommendation were nearly identical and the Putnam fund had outperformed the Alliance fund in the year 2000.

[32] Among other things, the Commission has found that "a generally declining market" or a fund's "poor performance" were not sufficient reasons to rebut the presumption of improper mutual fund switches. *See Charles E. Marland & Co., Inc.*, 45 S.E.C. 632, 634-35 (1974); *see also Kinderdick*, 46 S.E.C. at 638 (finding implausible the claim that mutual fund switch transactions were suitable due to a desire for "better performance").

Based upon the foregoing, we affirm the Hearing Panel's findings that Epstein violated NASD Rules 2310, 2110, and IM-2310-2.[33]

B. Epstein's Alleged Fraudulent Misrepresentations and Omissions

In addition to alleging that Epstein made unsuitable mutual fund switch recommendations to 12 customers, Enforcement also averred that these recommendations were accompanied by misrepresentations and omissions of material fact that violated the antifraud provisions of the federal securities laws and NASD rules.[34] Although we recognize the sometimes close connection that misrepresentations and omissions of fact play in findings of unsuitability,[35] we have determined that we need not analyze whether the facts of this case also prove fraud, including all of its elements, given our unmistakable finding that Epstein's mutual fund sale and purchase recommendations were unsuitable and our determination, discussed below, that a bar remains an appropriate sanction for Epstein's misconduct. Our decision thus does not reach the issue of whether Epstein violated Exchange Act Section 10(b), Exchange Act Rule 10b-5, and NASD Rules 2120, 2110, and IM-2310-2.

C. Epstein's Arguments on Appeal

Epstein asserts that he should be exonerated of any misconduct, or given a new hearing, due to a compendium of abuses that he is alleged to have suffered in this case. Among other things, Epstein claims collusion by FINRA and its staff with Merrill Lynch and its representatives, bias on the part of the Hearing Officer assigned to the proceedings below, and numerous abuses of the NASD Rules -- all which were apparently designed to "cover-up" and conceal securities industry abuses and "scapegoat" Epstein. We have considered each of these arguments thoroughly and find them to be without merit.

1. Epstein's Conspiracy Theories

Epstein asserts that FINRA and Merrill Lynch colluded to file the disciplinary complaint in this matter for the purpose of covering up unlawful acts committed by Merrill Lynch and its

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33 A violation of the NASD suitability rule is also a violation of NASD Rule 2110. *See Belden*, 2003 SEC LEXIS 1154, at *14.

34 Exchange Act Section 10(b), Exchange Act Rule 10b-5, and NASD Rule 2120 all prohibit fraudulent and deceptive acts and practices in connection with the offer, purchase, or sale of a security. A violation of these antifraud provisions is established by a showing that a person, acting with scienter, misrepresented or omitted material facts in connection with a securities transaction. *Dane S. Faber*, 2004 SEC LEXIS 277, at *13-14.

35 *See Dep't of Enforcement v. Frankfort*, Complaint No. C02040032, 2007 NASD Discip. LEXIS 16, at *31 (NASD NAC May 24, 2007) ("Frankfort's failure to disclose the Fund's losses plays an important part in finding both a material omission and unsuitability."); *see also NASD Notice to Members 94-16* (concluding that the disclosure of material facts is "inextricably entwined" with the suitability determination for mutual fund investments).

senior representatives in the operation of the Financial Advisory Center. This conspiracy, Epstein further argues, served to make Epstein a "scapegoat" for many securities industry abuses and to divert attention from what Epstein views as FINRA's failure to take action against Merrill Lynch for its misconduct. We do not credit these assertions.

First, as to Epstein's claims that he has been the victim of bias on the part of FINRA staff and the securities industry, we find that these claims are unsubstantiated and are an insufficient basis to invalidate these proceedings.[36] *Dist. Bus. Conduct Comm. v. Guevara*, Complaint No. C9A970018, 1999 NASD Discip. LEXIS 1, at *39 & n.16 (NASD NAC Jan. 28, 1999), *aff'd*, 54 S.E.C. 655 (2000); *see also Dan Adlai Druz*, 52 S.E.C. 416, 429 (1995), *aff'd*, 103 F.3d 112 (3d Cir. 1996) (rejecting a "myriad of accusations of impropriety involving fraud, corruption, and collusion by the Chief Hearing Officer, the Exchange's Division of Enforcement, and [the respondent's firm]"). The record demonstrates that the genesis of these proceedings was a customer complaint received by FINRA staff concerning mutual fund switch transactions recommended to the customer by Epstein. After receiving the customer complaint, FINRA staff conducted a broader investigation of Epstein's mutual fund switch activities on behalf of Financial Advisory Center customers. That investigation led to the filing of a disciplinary complaint charging Epstein with violations of the federal securities laws and NASD rules.

Second, the decisions to initiate an investigation of Epstein and to commence disciplinary proceedings concerning his alleged misconduct are exercises of FINRA's prosecutorial discretion.[37] *Schellenbach v. SEC*, 989 F.2d at 912. Absent a showing of selective enforcement, the motives behind these decisions are irrelevant. *Id*. To succeed on a claim of improper selective prosecution, Epstein must establish that he was singled out for discipline while others who were similarly situated were not, and that this action was motivated by arbitrary or unjust considerations such as race, religion, or the desire to prevent the exercise of a constitutionally-protected right. *Eagletech Communications, Inc.*, 2006 SEC LEXIS 1534, at *14-15. Epstein has neither alleged nor proven any of these elements.

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[36] Moreover, de novo review of Hearing Panel decisions by the NAC further ensures that the FINRA disciplinary proceedings are conducted fairly and without bias. *Dep't of Enforcement v. Sathianathan*, Complaint No. C9B030076, 2006 NASD Discip. LEXIS 3, at *51 (NASD NAC Feb. 21, 2006), *aff'd*, Exchange Act Rel No. 54722, 2006 SEC LEXIS 2572 (Nov. 8, 2006).

[37] To the extent that Epstein's argument is that FINRA decided not to take enforcement action against other wrongdoers, such a decision, if any, would also constitute an exercise of FINRA's prosecutorial and regulatory discretion. *Cf. Heckler v. Chaney*, 470 U.S. 821, 831 (1985) ("an agency's decision not to prosecute or enforce . . . is a decision generally committed to an agency's absolute discretion"); *Bd. of Trade of City of Chicago v. SEC*, 883 F.2d 525, 530 (7th Cir. 1989) ("Refusal to prosecute is a classic illustration of a decision committed to agency discretion."). FINRA staff's refusal to prosecute another is thus not reviewable. *See Schellenbach v. SEC*, 989 F.2d 907, 912 (7th Cir. 1993); *see also Eagletech Communications, Inc.*, Exchange Act Rel. No. 54095, 2006 SEC LEXIS 1534, at *15 (July 5, 2006) (finding that a decision not to prosecute is an exercise of prosecutorial and regulatory discretion and is presumptively unreviewable).

Finally, we note that Epstein's allegations of a "cover-up" fall under the weight of logic and reality. Epstein claims that the decision to bring an enforcement action against him was the result of a desire on the part of FINRA and Merrill Lynch to conceal pervasive fraud within the securities industry concerning the sale of mutual funds. He fails to recognize, however, that the commencement of proceedings and the issuance of a disciplinary decision in this case served to shed light upon the very abuses he claims were meant to be swept under the carpet and away from public view.

Indeed, as a result of a separate FINRA investigation, on March 15, 2006, Merrill Lynch accepted a letter of Acceptance, Waiver & Consent ("AWC") in which FINRA found that, in connection with the operation of its Financial Advisory Center, Merrill Lynch had engaged in supervisory failures, registration violations, impermissible sales contests and other violations of NASD rules. FINRA found, among other things, that Merrill Lynch did not have an adequate supervisory system and procedures to oversee its Investment Services Advisors, who had engaged in a pattern of mutual fund switch recommendations that were accompanied by misrepresentations and omissions of facts to customers. Without admitting or denying FINRA's findings, Merrill Lynch agreed to the entry of FINRA's findings, a censure, and a $5,000,000 fine.

2. Epstein's Motion to Adduce Additional Evidence

NASD Rule 9346(b) permits a party to apply for leave to introduce additional evidence by a motion filed not later than 30 days after OHO transmits to the NAC, and serves upon all parties, the index to the record. A motion made pursuant to NASD Rule 9346(b) must describe each item of proposed new evidence, demonstrate that there was good cause for failing to introduce it below, and demonstrate why the evidence is material to the proceeding.

Epstein filed a motion on April 25, 2006, seeking to adduce certain "exculpatory" evidence that he claims was improperly withheld from him by Enforcement. OHO certified the record in this case on December 19, 2005. Respondent's motion to introduce additional evidence was therefore untimely filed.

A party, however, may request an extension of the 30-day period within which to file a motion to adduce additional evidence where good cause exists. Although Epstein did not set forth any explicit argument that good cause existed in this case, it appears that he only obtained on March 15, 2006, the documents for which he sought leave to introduce, when such documents were produced to him in an arbitration proceeding that Epstein instituted against Merrill Lynch and representatives of the firm.

The additional evidence that Epstein sought leave to introduce in this appellate proceeding consists of: 1) a "Wells" notice served upon Merrill Lynch by Enforcement; 2) Merrill Lynch's response to the Wells notice; and 3) transcripts of on-the-record testimony taken by FINRA staff from 15 representatives of Merrill Lynch in another investigative matter who are apparently individual respondents in Epstein's arbitration claim. Epstein asserts that this evidence would serve to exculpate him, and is therefore material, because it would establish that his acts of misconduct were committed with the encouragement and approval of Merrill Lynch, and resulted from a general lack of supervision and training of young and inexperienced Investment Services Advisors employed by Merrill Lynch at the Financial Advisory Center.

The subcommittee of the NAC ("Subcommittee") empanelled to hear oral argument in this case denied Epstein's motion to adduce additional evidence, finding Epstein failed to establish that the additional evidence he sought leave to introduce was material to the claims at issue in these proceedings. We agree with the Subcommittee and accept its ruling as our own.

The additional evidence sought by Epstein is immaterial to the issue of his liability or lack thereof for the violations alleged in Enforcement's complaint. A registered representative cannot shift to others his or her responsibility to refrain from committing fraud or to make suitable recommendations. *See SEC v. Hasho*, 784 F. Supp. 1059, 1108 (S.D.N.Y. 1992) ("Salesmen or registered representatives have certain duties that they cannot avoid by reliance on either their employer or issuer."); *Justine Susan Fischer*, 53 S.E.C. 734, 741& n.4 (1998) ("Fischer . . . cannot use PaineWebber or its employees as a shield [from liability for misrepresentations and omissions]."); *see also Faber*, 2004 S.E.C. Lexis 277, at * 21 (rejecting argument that respondent did not possess the scienter necessary to establish liability for fraudulent misrepresentations and omissions where respondent argued that he relied on information provided by his firm and that the firm's owners were the "true culprits"); *Kenneth R. Ward*, Exchange Act Rel. No. 47535, 2003 SEC LEXIS 687, at *50 (March 19, 2003) ("The complicity of others, whether through overt assistance and encouragement or through neglect, did not relieve respondent of his fundamental duty to make suitable recommendations to his customers."). It was Epstein's responsibility, and his alone, to determine the suitability of the recommendations that he made to the Financial Advisory Center customers with whom he dealt.[38] *Patrick G. Keel*, 51 S.E.C. 282, 284-85 (1993). Epstein may not invoke his youth, inexperience, or a lack of training as a safeguard for the violations that we affirm herein. *See Hasho*, 784 F.Supp. at 1108 ("Those who hold themselves out as professionals with specialized knowledge and skill to furnish guidance can not be heard to claim youth or inexperience when faced with charges of violations of the anti-fraud provisions of the securities laws."); *see also Patricia H. Smith*, 52 S.E.C. 346, 348 n.8 (1995) ("[I]gnorance of NASD requirements is no excuse for violative behavior.").

In denying Epstein's motion to adduce, we further deny Epstein's request that this case be remanded and that Enforcement be compelled to produce unspecified "exculpatory documents" that FINRA staff obtained in other investigative matters. Contrary to Epstein's assertion, the Code of Procedure does not grant, and cannot be read to grant, a respondent

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[38] Epstein cannot use Merrill Lynch's general supervisory approval of certain mutual fund investments for sale to its customers as a substitute for his own judgment on the issue of suitability. *See Larry Ira Klein*, 52 S.E.C. 1030, 1038 n.30 (1996). Nor can he look to the approval of the transactions at issue in this case by Merrill Lynch supervisory personnel to escape liability. *Cf. Sharon M. Graham*, 53 S.E.C. 1072, 1084-85 (1998) (finding that a salesperson aided and abetted antifraud violations notwithstanding a compliance officer's assurances that the trades were "fine"), *aff'd*, 222 F.3d 994 (D.C. Cir. 2000).

wholesale discovery of the investigative files of FINRA staff. NASD Rule 9251 requires that Enforcement provide the respondent, for inspection and copying, the documents prepared or obtained in connection with Enforcement's investigation that led to the institution of disciplinary proceedings against Epstein, or documents obtained pursuant to NASD Rule 8210 after the complaint was filed. Enforcement, however, is not required to produce to respondent any documents that would disclose FINRA examination, investigation, or enforcement techniques, the identity of confidential sources, or any documents that would disclose the existence of an examination, investigation, or proceeding under consideration by or initiated by FINRA staff.[39] NASD Rule 9251(b)(1). We find no evidence that Enforcement withheld any exculpatory evidence or did not abide by its obligation to produce documents under NASD Rule 9251.

3. Hearing Officer Bias

A Hearing Officer may be disqualified "based upon a reasonable, good faith belief that a conflict of interest or bias exists or circumstances otherwise exist where the Hearing Officer's fairness might reasonably be questioned." NASD Procedural Rule 9233(b). To be disqualifying, a claimed bias or prejudice must stem from an extrajudicial source and result in an opinion on the merits on a basis other than what the Hearing Officer learned from participation in the case. *Cf. United States v. Grinnell Corp.*, 384 U.S. 563, 583 (1966) (interpreting 28 U.S.C. § 144, the federal bias statute for district court judges).

Epstein claims that he was denied a fair hearing due to the alleged bias of the Hearing Officer assigned to this matter and requests a new hearing. Epstein contends that the Hearing Officer's bias is evident from an examination of "numerous erroneous and unfair rulings" made by the Hearing Officer in the course of the disciplinary proceedings. A Hearing Officer's adverse judicial rulings during the course of the proceedings, however, are insufficient grounds for disqualification. *Cf. United States v. Azhocar*, 581 F.2d 735, 739 (9th Cir. 1978) ("Adverse rulings do not constitute the requisite bias or prejudice under [28 U.S.C.] § 144."). Absent allegations or evidence of an extrajudicial source of prejudice, we find that no basis exists to support Epstein's assertion that the Hearing Officer's rulings amount to bias. *See Gibbs v. SEC*, 1994 U.S. App. LEXIS 10771, at *15 (10th Cir. 1994) ("a substantial showing of personal bias is required to disqualify" a hearing officer).

Nor do we find any error in the rulings that Epstein asserts are evidence of the Hearing Officer's bias. First, Epstein contends that the Hearing Officer erred in deciding to strike Epstein's "affirmative defenses," which claimed that FINRA staff filed the complaint in this matter to interfere with and delay an arbitration matter that Epstein filed against Merrill Lynch and certain representatives of the firm. We disagree.

An affirmative defense is a respondent's "assertion raising new facts and arguments that, if true, will defeat the plaintiff's or prosecution's claim, even if all allegations in the complaint

[39] NASD Rule 9251(b)(2) further provides that "[n]othing in subparagraph (b)(1) authorizes the Department of Enforcement . . . to withhold a Document, or part thereof, that contains material exculpatory evidence."

are true." *Rochelle Saks v. Franklin Covey Co.*, 316 F.3d 337, 350 (2d Cir. 2003) (quoting Black's Law Dictionary 430 (7th ed. 1999)); *accord Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. City Savings, F.S.B.*, 28 F.3d 376, 393 (3d Cir. 1994). The practice in disciplinary proceedings is to strike those affirmative defenses that do not constitute a valid defense to avoid wasting time litigating irrelevant facts. *Gregory L. Amico*, Admin. Proc. Rulings Rel No. 460, 1994 SEC LEXIS 4039, at *1 (Dec. 15, 1994). Epstein may not maintain, as a matter of law, any defense that rests upon an assertion of FINRA misconduct to reduce or eliminate his own misconduct. *Cf. FTC v. Image Sales and Consultants, Inc.*, No. 97-Civ.-131, 1997 U.S. Dist. LEXIS 18942, at *7-8 (N.D. Ind. Sept. 17, 1997) (finding that the doctrine of unclean hands may not be invoked as an affirmative defense against a regulatory agency that is attempting to enforce a congressional mandate in the public interest); *FDIC v. Isham*, 782 F. Supp. 524, 531-32 (D. Colo. 1992) ("FDIC's conduct in fulfilling its mandate involves discretionary decisions that should not be subject to judicial second guessing."); *see also Jeffrey L. Feldman*, Admin. Proc. Rulings Rel. No. 403, 1994 SEC LEXIS 186, at *4 (Jan. 14, 1994) (striking an affirmative defense that the Commission perpetrated an abuse of discretion by bringing a disciplinary complaint because the Commission's reasons for initiating the proceeding were beyond review). We thus affirm the Hearing Officer's decision to strike Epstein's affirmative defenses.

Second, Epstein asserts that the Hearing Officer wrongfully limited his ability to introduce evidence and present witnesses. FINRA Hearing Officers are empowered to resolve any procedural and evidentiary matters, discovery requests, and other non-dispositive motions, subject to any limitations elsewhere in the Code of Procedure. NASD Rule 9235(a)(4). In this case, Epstein failed to abide by the Hearing Officer's order, issued under NASD Rule 9242, directing each party to provide the other and the Hearing Officer copies of the documentary evidence and a list of the witnesses that each party intended to present at the disciplinary hearing. NASD Rule 9280(b)(2) expressly grants a Hearing Officer the power to not permit at the hearing the presentation of any witness or the use of any evidence by a party that, without substantial justification, fails to disclose information required by NASD Rule 9242. We agree with the Hearing Officer that Epstein failed to provide *any* justification, let alone substantial justification, for his failure to abide by the Hearing Officer's pre-hearing order and that such failure was not harmless. We therefore affirm the Hearing Officer's decision to preclude Epstein from offering any testimony, except his own, or any documents into evidence at the hearing.

Third, Epstein claims that the Hearing Officer erred in restricting his counsel's questioning of an Enforcement witness who testified at the hearing. Although this claim lacks specificity and is conclusory in nature, it appears that Epstein's assertion of error rests upon the Hearing Officer's decision to limit questions concerning the scope and adequacy of staff's investigation into this and other matters. We find no error in the Hearing Officer's ruling limiting cross-examination. The Code of Procedure grants the Hearing Officer broad discretion to accept or reject evidence. *Dep't of Enforcement v. Fiero*, Complaint No. CAF980002, 2002 NASD Discip. LEXIS 16, at *89 (NASD NAC Oct. 28, 2002). The Hearing Officer may "exclude all evidence that is irrelevant, immaterial, unduly repetitious, or unduly prejudicial." NASD Rule 9263(a)(2). We find that questions concerning the scope and adequacy of investigations conducted by FINRA staff were properly ruled on by the Hearing Officer as being beyond the purview of the hearing below. *See Dep't of Enforcement v. Sturm*, Complaint No. CAF000033, 2002 NASD Discip. LEXIS 2, at *18 (NASD NAC March 21, 2002) ("[W]e find no error in the Hearing Officer's rulings that restricted Sturm's questioning of Park to issues relevant to Sturm's failure to respond."); *see also Thomas E. Warren, III*, 51 S.E.C. 1015, 1020 (1994) (rejecting arguments that a hearing was unfair because FINRA conducted an inadequate investigation or did not conduct interviews that the respondent asserted could assist him in his defense), *aff'd*, 1995 U.S. App. LEXIS 30824 (10th Cir. 1995).

Finally, Epstein claims that the Hearing Officer wrongly refused a request to reschedule the disciplinary hearing below. We disagree. The Hearing Officer is expressly charged with "regulating the course of the hearing." NASD Rule 9235(a)(2). It is well settled that in FINRA disciplinary proceedings, the Hearing Officer has broad discretion in scheduling matters. *See Falcon Trading Group, Ltd.*, 52 S.E.C. 554, 560 (1995) ("[T]he trier of fact has broad discretion in determining whether a request for continuance should be granted, based upon the particular facts and circumstances presented."), *aff'd*, 102 F.3d 579, 581 (D.C. Cir. 1996). While notice of at least 28 days is required by NASD Rule 9221(d), Epstein was given four months notice of the hearing dates. In light of the ample time Epstein had to prepare for hearing, and given the straightforward nature of Enforcement's claims against him, we find that the Hearing Officer's scheduling of this matter was justified and did not constitute "'an unreasoning and arbitrary insistence upon expeditiousness in the face of a justifiable request for delay.'" *See Richard W. Suter*, 47 S.E.C. 951, 963 (1983) (*quoting Morris v. Slappy*, 461 U.S. 1, 11 (1983)).

IV. Sanctions

The Hearing Panel barred Epstein from associating with any FINRA member in any capacity. Epstein argues that the sanction imposed was improper and that he was not afforded all considerations to which he was entitled under the FINRA Sanction Guidelines ("Guidelines"). We disagree. Although we have dismissed allegations that Epstein engaged in fraud, we conclude that a bar is an appropriate sanction for Epstein's suitability violations.

In deciding upon an appropriate sanction, we have considered both the Guidelines' principal considerations and the considerations that are specific to suitability violations. The Guidelines for unsuitable recommendations suggest a fine of $2,500 to $75,000.[40] In addition, the Guidelines suggest a suspension of 10 business days to one year and, in egregious cases, adjudicators should consider a suspension of up to two years or a bar.[41]

In concluding that a bar is an appropriate sanction, we have considered the number of acts of misconduct and the period of time over which these acts were perpetrated.[42] Given that Epstein made unsuitable recommendations to at least 12 customers over a period of several months, we find that Epstein systematically failed to uphold high standards of commercial honor.

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40 *FINRA Sanction Guidelines* 99 (2007) (Suitability—Unsuitable Recommendations), http://www.finra.org/web/groups/enforcement/documents/enforcement/p011038 [hereinafter *Guidelines*].

41 *Id*.

42 *Id*. at 6 (Principal Considerations in Determining Sanctions, Nos. 8, 9).

Epstein's conduct was not the result of a momentary lapse of judgment that might establish mitigation.[43]

Epstein's misconduct involved injury to numerous retired, elderly, and unsophisticated customers who needlessly incurred contingent deferred sales charges, extended CDSC holding periods, higher expenses, and lower yields as a direct consequence of Epstein's recommendations.[44] We have further considered the fact that Epstein's misconduct resulted in his monetary gain.[45] *See Belden*, 2003 SEC LEXIS 1154, at *16 ("The NASD properly considered in determining sanctions that Belden placed the paying of his firm's expenses above the interests of his customer.").

We find that Epstein's misconduct was egregious. Epstein abused the trust of the customers with whom he dealt and consistently recommended transactions outside of an existing fund family, saddled customers with higher expense ratios, and ignored concerns raised by customers while emphasizing purchases that, in fact, left the customers with no discernible investment gain. As a result of Epstein's actions, the Financial Advisory Center customers with whom he dealt could not make informed investment decisions and truly assess whether an investment in a particular fund or share class was ultimately in their best interests. Epstein recommended mutual fund switch transactions without concern for the customers' understanding of the risks involved and of the net investment advantage or disadvantage that could result from the transactions.

As to the merits of Epstein's claims for mitigation, we reject them. Throughout these proceedings Epstein has attempted to portray himself as a hapless victim. In this vein, Epstein argues that he fell prey to Merrill Lynch institutional pressures, inadequate training, and a lack of supervision. Even if true, these claims would not serve to mitigate the bar imposed in this case.

First, if Epstein felt pressured to engage in misconduct, it was not an appropriate reaction to succumb to such pressure. *See Dist. Bus. Conduct Comm. v. Bozzi*, Complaint No. C10970003, 1999 NASD Discip. LEXIS 5, at *16 (NASD NAC Jan. 13, 1999) (finding the alleged fact that a registered representative succumbed to institutional pressure to submit falsified life insurance applications is not a factor that warrants mitigation of sanctions). Second, we do not accept the proposition, given the facts of this case, that if conduct is pervasive, or even approved by a firm, it should mitigate the sanction imposed. *See Charles E. Kautz*, 52 S.E.C. 730, 733, 736 (1996) (holding that assertions that the falsification of documents was accepted or approved by the firm did not call for mitigation of sanctions); *see also Smith* 52 S.E.C. at 348 n. 8 (finding that "it is no defense that others in the industry may have been operating in a similarly illegal or improper manner"). Neither a respondent's claimed ignorance of the securities laws,

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43 We do not accept as a mitigating factor Epstein's lack of disciplinary history. *See Rooms v. SEC*, 444 F.3d 1208, 1214 (10th Cir. 2006) ("Lack of a disciplinary history is not a mitigating factor.").

44 *Guidelines*, at 6-7 (Principal Considerations in Determining Sanctions, Nos. 11, 19).

45 *Id.* at 7 (Principal Considerations in Determining Sanctions, No. 17).

nor a respondent's attempt to shift responsibility for a failure to comply with the securities laws to inadequate training or incompetent supervision, will serve to lessen the sanction imposed. *See Thomas C. Kocherhans*, 52 S.E.C. 528, 531-532, 534 (1995) (concluding that ignorance of NASD rules and absence of supervisory structure do not compel a reduction of sanction); *Smith*, 52 S.E.C. at 348 (finding respondent's claim that her misconduct resulted from the training she received not mitigating); *see also Dep't of Enforcement v. Dieffenbach*, Complaint No. C06020003, 2004 NASD Discip. LEXIS 10, at 43 (NASD NAC July 30, 2004) ("We reject the Hearing Panel's conclusion that the Firm's inadequate training and supervision mitigates the respondents' failures in this regard."); *Mkt. Reg. Comm. v Shaughnessy*, Complaint No. CMS950087, 1997 NASD Discip. LEXIS 46, at *30-31 (NASD NBCC June 5, 1997) (rejecting premise that lack of instruction as to the improper nature of conduct is mitigating factor for purposes of sanctions), *aff'd*, 53 S.E.C. 692 (1998).

Epstein asserts that he was naively set up as a "scapegoat," and claims on appeal that the disciplinary proceedings below were unfair and denied him the opportunity to establish this alleged truth. The record shows that Epstein was given every opportunity to present his relevant defenses in accordance with NASD procedure. We therefore reject Epstein's argument that he was not provided with a fair hearing.

In addition, we find disquieting Epstein's failure to account for his actions. Epstein's failure to accept responsibility for his own actions and his continued blame of others for the circumstances that have occurred are aggravating factors that we have considered in reaching our conclusion that a bar is an appropriate sanction in this case.[46] *See Shaughnessy*, 1997 NASD Discip. LEXIS 46, at *32-33 ("[T]he Commission has found that it is necessary to bar respondents who . . . fail to accept responsibility for their actions and continue to place blame on others.").

We also find it disquieting, and have considered it relevant in assessing the appropriate remedial sanctions, that the Hearing Panel determined that Epstein was not forthright in testimony given by him to FINRA staff during the investigation of this matter. We agree with the Hearing Panel's assessment. Providing inaccurate information in an effort to minimize one's own responsibility serves to aggravate sanctions.[47]

In this regard, we reject Epstein's assertion that he provided substantial assistance to FINRA staff during its investigation. Compliance with duties imposed under NASD Rule 8210 to provide information or testimony during a FINRA examination, investigation, or proceeding does not, as Epstein contends, warrant a mitigation of sanctions. *See Dep't of Enforcement v. Keyes*, Complaint No. C02040016, 2005 NASD Discip. LEXIS 9, at *28 (NASD NAC Dec. 28, 2005) ("We do not find that Keyes provided substantial assistance to NASD but, instead, cooperated with the investigation as he was obligated to do."), *aff'd in relevant part*, Exchange Act Rel. No. 54723, 2006 SEC LEXIS 2631 (Nov. 8, 2006).

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[46] *Id*. at 6 (Principal Considerations in Determining Sanctions, No. 3).

[47] *Id*. at 7 (Principal Considerations in Determining Sanctions, No. 12).

The securities industry "presents a great many opportunities for abuse and overreaching, and depends heavily on the integrity of its participants." *Bernard D. Gorniak*, 52 S.E.C. 371, 373 (1995). In light of our duty to protect the investing public and ensure the integrity of the market, we find we must act decisively in cases, like this one, in which the evidence proves that Epstein lacks an understanding of his duty as a registered person to ensure that he recommends suitable transactions.[48] *See Sathianathan*, 2006 SEC LEXIS 2572, at *43 ("[N]umerous violations of NASD's suitability rule warrant serious sanctions."). We find that Epstein's demonstrated insouciance and indifference towards his responsibilities under NASD rules poses a serious risk to the investing public. We conclude that a bar is necessary to prevent Epstein from inflicting the same harm upon customers in the future that he inflicted upon his customers in this case. A bar will also serve to deter others from engaging in similar misconduct.

Accordingly, we bar Epstein from acting in any capacity with any FINRA member firm.

V. <u>Conclusion</u>

We affirm the Hearing Panel's findings that Epstein made unsuitable recommendations, in violation of NASD Rules 2310, 2110, and IM-2310-2. We decline to reach allegations and findings that Epstein made material misrepresentations and omissions when he recommended mutual fund switch transactions to customers, in violation of Section 10(b) of the Exchange Act, Exchange Act Rule 10b-5, and NASD Rules 2120, 2110, and IM-2310-2. Nonetheless, we find that barring Epstein remains in order. The bar is effective upon service of this decision. We affirm the Hearing Panel's imposition of hearing costs against Epstein in the amount of $4,398.20.[49]

On Behalf of the National Adjudicatory Council,

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Barbara Z. Sweeney, Senior Vice President
and Corporate Secretary

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48 In his appeal brief, Epstein asserts that he "was not aware of the violations with which he is charged . . . either before, during or after they occurred." He further states that, "[o]nly from being named a scapegoat by Merrill Lynch and the NASD . . . does respondent now understand the wrongdoings that were intended to be an integral part of the operations of the Merrill Lynch FAC offices."

49 We also have considered and reject without discussion all other arguments of the parties. Pursuant to NASD Rule 8320, any member that fails to pay any fine, costs, or other monetary sanction imposed in this decision, after seven days' notice in writing, will summarily be suspended or expelled from membership for nonpayment. Similarly, the registration of any person associated with a member who fails to pay any fine, costs, or other monetary sanction, after seven days' notice in writing, will summarily be revoked for nonpayment.