NASD REGULATION, INC.
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. ROBERT JOSEPH KERNWEIS (CRD #1392867), et al. WILLIAM POHN WILLIS (CRD #836417) Rancho Palos Verdes, California ARNOLD HINSDALE KRAUS (CRD #275067) Tucson, Arizona KEITH ALLEN DIETERICH (CRD #1063267) San Francisco, California Respondents.	Disciplinary Proceeding No. C02980024 Hearing Officer - EAE HEARING PANEL DECISION DECISION AS TO RESPONDENTS WILLIAM POHN WILLIS, ARNOLD HINSDALE KRAUS, AND KEITH ALLEN DIETERICH February 16, 2000

DIGEST

On June 1, 1998, the Department of Enforcement ("Enforcement" or "Complainant") filed a Complaint against seven Respondents, member firm Sutro & Co., Inc. ("Sutro" or "the Firm") and six persons associated with the Firm: Robert Joseph Kernweis ("R. Kernweis"); Glenn Peter Kernweis ("G. Kernweis"); Greg Steven Sklar ("Sklar"); William Pohn Willis ("Willis"); Arnold Hinsdale Kraus ("Kraus"), and Keith Allen Dieterich ("Dieterich"). During the relevant time period, from January 1, 1993

through June 30, 1994, Respondents R. Kernweis, G. Kernweis, and Sklar were general securities representatives conducting business at Sutro as the KKS Group under one investment account executive ("AE") number. Respondent Willis was a General Securities Sales Supervisor and the Branch Office Manager for Sutro's Los Angeles branch office. Respondent Kraus was a General Securities Principal and the Executive Vice President and Director of Retail for Sutro. Respondent Dieterich was a General Securities Sales Supervisor and Sutro's Director of Compliance.

Prior to, or at the time of the Hearing, Respondents Sutro, G. Kernweis, and Sklar settled with Complainant.[1] Respondents Willis, Kraus, and Dieterich (collectively referred to as the "Defending Respondents") appeared at the Hearing through counsel and contested the allegations of the Complaint.

Complainant alleges that the KKS Group, through Respondent R. Kernweis, engaged in trading in the account of a public customer, FPG, that was not suitable based on the size, nature, and frequency of the recommended transactions; that these recommendations were made with an intent to defraud or a willful or reckless attempt to

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[1] The Hearing Officer signed an Order Accepting Offer of Settlement on March 18, 1999 and an Order Accepting Amended Offer of Settlement on March 25, 1999 as to Respondent Sutro. The Amended Offer of Settlement executed by Sutro provided that Sutro failed to establish, maintain and/or enforce clear lines of authority and responsibility in response to certain findings of its supervision of the KKS Group cited in a New York Stock Exchange ("NYSE") Special Examination Report ("the Report") and Sutro's undertakings made to the NYSE in response to that Report. Accordingly, Sutro was censured and fined $60,000.

On March 30, 1999, the Hearing Officer signed an Order Accepting Offer of Settlement as to Respondent G. Kernweis. Pursuant to that Order, G. Kernweis was censured, suspended for sixty (60) days, ordered to requalify by examination as a GSR, and fined $30,000. After the Hearing commenced, the Hearing Panel approved an Offer of Settlement as to Respondent Sklar (Transcript ("Tr."), March 25, 1999 at 758-760) which was accepted by Complainant and the National Adjudicatory Council on April 23, 1999. Sklar was censured, ordered to requalify as a GSR, and fined $30,000. As to Respondent R. Kernweis, an Order was issued on November 5, 1998, finding him in default pursuant to Code of Procedure Rules 9215 and 9269. A separate default decision as to R. Kernweis will be issued.

generate commissions at the expense of FPG; and that such conduct violates NASD Conduct Rules 2110, 2120, and 2310.[2]

With respect to the Defending Respondents, Complainant alleges that, as managers, they had the authority and the obligation to prevent the unsuitable and excessive trading in the account of FPG and failed to take appropriate action to supervise the KKS Group. Complainant also alleges that Respondent Dieterich failed to establish adequate supervisory procedures. Defending Respondents' conduct is alleged to violate NASD Conduct Rules 2110 and 3010.[3]

At the conclusion of Complainant's case, the Defending Respondents moved to dismiss the charges against them,[4] which Complainant opposed.[5] The Hearing Panel found that Complainant had not met its burden to prove a *prima facie* case as to the violations alleged against Respondents Kraus and Dieterich and, accordingly, granted their motions.[6] The Hearing Panel found that Complainant had established a *prima facie* case that Respondent Willis failed to reasonably supervise the KKS Group with respect to

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[2] The First Cause of Complaint against R. Kernweis alleges that he made unsuitable recommendations in violation of NASD Conduct Rules 2110 and 2310. The Second Cause of Complaint against R. Kernweis alleges fraud in violation of NASD Conduct Rules 2110 and 2120. The Third Cause of Complaint against G. Kernweis and Sklar alleges violations of NASD Conduct Rule 2110 for failure to observe high standards of commercial honor and just and equitable principles of trade.

[3] The allegations against the Defending Respondents are set forth in the Fourth and Fifth Causes.

[4] Respondents Kraus and Dieterich made Motions for Summary Disposition (hereafter referred to respectively as "Kraus Motion" and "Dieterich Motion"). Respondent Willis made a Motion to Dismiss ("Willis Motion").

[5] See Complainant's Opposition to Respondents' Motions for Verdicts ("Complainant's Opp.").

[6] Tr., June 8, 1999 at 1689; June 9, 1999 at 1794-96.

trading in the FPG Account in violation of NASD Conduct Rules 2110 and 3010 and, accordingly, denied his Motion.[7]

Based on the evidence presented at the Hearing and the post-hearing briefs,[8] the Panel determined that the following sanctions are appropriate for Respondent Willis: (1) a $10,000 fine; (2) requalification by examination as a principal (Series 24) within ninety (90) days of the date this decision becomes the final disciplinary action of the Association; and (3) a thirty (30) day suspension from associating with any member firm in a supervisory capacity, such suspension to run concurrently with requalification.

The Hearing Panel assessed $1,498.25, which represents a portion of the total costs of the Hearing, ($5,243.00 for transcripts and $750.00 administrative fee) against Respondent Willis.[9]

APPEARANCES

Karol L. K. Pollock, Esq., Regional Counsel, NASD Regulation, Inc., Department of Enforcement, District 2, Los Angeles, CA and Rory C. Flynn, Esq., Chief of Litigation, NASD Regulation, Department of Enforcement, Washington, DC for Complainant.

Paul J. Roshka, Jr., Esq., and Randall H. Warner, Esq., Roshka Heyman & De Wulf, Phoenix, AZ for Respondent Willis.

Peter Brown Dolan, Esq., and Randi Perry Spallina, Esq., Morgan, Lewis & Bockius L.L.P., Los Angeles, CA for Respondent Kraus.

Michael J. Abbott, Esq., and Karen N. Sample, Esq., Jones, Bell, Abbott, Fleming & Fitzgerald L.L.P., Los Angeles, CA for Respondent Dieterich.

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[7] Id. at 1796-97. Prior to the ruling on the motions, the Parties agreed that no further evidence would be presented to the Panel. Tr., June 8, 1999 at 1689-1690. Accordingly, rather than hear arguments on the issue of appropriate sanctions against Respondent Willis, the Hearing Panel ordered post-hearing briefs. Id. at 1796.

[8] See Complainant's Post-Hearing Brief On The Issue Of Sanctions ("Complainant's Br.") and William Pohn Willis' Post-Hearing Brief On The Issue Of Sanctions ("Willis' Br.").

[9] Because the evidence presented at the Hearing related not only to Respondent Willis, but also to the other two Defending Respondents against whom Complainant was not successful, the Hearing Panel did not assess the full cost ($5,993.00) against Respondent Willis.

DECISION

I. SUMMARY OF THE CASE

On June 1, 1998, Enforcement filed a Complaint asserting various charges against member firm Sutro and six (6) individuals associated with the Firm. The charges at issue here are those set forth in the Fourth and Fifth Causes. The Fourth Cause charges the Defending Respondents and Sutro with failure to supervise the KKS Group with respect to trading in the account of Customer FPG and the Fifth Cause charges Respondents Dieterich and Sutro with failure to establish adequate supervisory procedures.

During the relevant period, Defending Respondents were supervisors at Sutro.[10] Respondent Willis was the Senior Vice President/Branch Manager of the Firm's Los Angeles' office[11] and the direct supervisor of the KKS Group.[12] Respondent Kraus was the Executive Vice President of Sutro and Director of Retail[13] and Respondent Willis' direct supervisor.[14] Respondent Dieterich was Sutro's Director of Compliance.[15]

A. The FPG Account

Customer FPG was a client of the KKS Group from approximately January 1993 through June 1994.[16] He resides in Houston and is a retired chemical sales representative

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[10] Sutro is an NASD member with its principal office in San Francisco, CA. In 1993, the Firm had 21 branch offices, including the Los Angeles branch office which was its largest branch office. Joint Stipulations at ¶8. The KKS Group was located in the Los Angeles office, and FPG's account was maintained there. Joint Stipulations at ¶¶1-3.

[11] Tr., June 8, 1999 at 1575; Joint Stipulation at ¶5.

[12] Joint Stipulation at ¶5.

[13] Tr., May 5, 1999 at 1285; Joint Stipulation at ¶6.

[14] Joint Stipulation at ¶6.

[15] Tr., May 5, 1999 at 1189; Joint Stipulation at ¶7.

[16] FPG was solicited to open an account by Respondent R. Kernweis in December 1992. Joint Stipulation at ¶13; Tr., March 23, 1999 at 112. The first trade took place in January 1993 and was solicited and

who was employed by the Shell Oil Company for approximately 37 years.[17] When he retired in 1991, his salary was approximately $62,000 per year,[18] and he received a severance package of approximately $100,000.00.[19]

As a result of a cold call, FPG opened an account at Sutro in January 1993 with an initial investment of $5,000.[20] At that time his net worth was approximately $1 million (consisting of the money in his Shell 401(k) plan) and his combined family annual income was $75,000.[21] FPG testified that prior to opening his account with Sutro, most of his money was in the Shell 401(k) plan and that he had little investment experience.[22]

The KKS Group, specifically R. Kernweis, was the AE for FPG's Account.[23] During the relevant time period there were 113 transactions in FPG's Trading Account.[24] With the exception of eleven (11) unsolicited liquidating transactions,[25] all the purchase

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effected by another Sutro AE. Id. at 114-115; Joint Exhibit 10 at 9. Joint Exhibits admitted into evidence are designated "JX." Complainant's Exhibits are designated "CX" and any exhibits introduced by a Respondent are designated by the Respondent's name.

[17] Tr., March 23, 1999 at 72, 76; see also Joint Stipulation at ¶15.

[18] Id. at 78.

[19] Id. at 77-78. FPG was paid $50,000 on January 1, 1992 and $50,000 on January 1, 1993. Tr., March 24, 1999 at 228.

[20] JX-3. This account was assigned No. 807-10772 ("the Trading Account"). Subsequently, FPG opened two IRA accounts at Sutro in June and November 1993. Joint Stipulation at ¶14; JXs-4 and 5.

[21] Tr., March 23, 1999 at 82-83. FPG received a pension of approximately $34,000 a year, and his wife, who worked as a temporary employee, earned approximately $30,000 a year. The new account form for the Trading Account reflects an estimated annual income of "$100,000 plus" and an estimated net worth, excluding residence, of "$1 million plus." The new account form was not signed by FPG. JX-3. See also Tr., March 23, 1999 at 117-118.

[22] Id. at 86. After he retired, FPG contacted Merrill Lynch to establish IRA accounts for purposes of rolling over his Shell 401(k) funds. At Merrill Lynch, he invested in tax deferred diversified portfolios of managed funds intended for long-term investment. Tr., March 23, 1999 at 90-91, 95-97; JX-13 at 9-481; JX-51.

[23] JX-3.

[24] Tr., May 4, 1999 at 903.

[25] Id. CX-4. See, e.g., JXs 6, 7 and 18. Almost all of the unsolicited liquidating transactions were necessitated by the fact that FPG had withdrawn funds from a qualified retirement account in order to

and sale transactions in FPG's Trading Account were solicited by Respondent R. Kernweis.[26] Almost all purchases in the Trading Account were made on margin.[27] During the eighteen month period, FPG transferred more than $700,000 to his Trading Account. The source of almost all of these funds was his qualified retirement accounts at Merrill Lynch.[28]

The trading in the FPG Account was characterized by large positions in a single speculative security at a given time and by the movement from one large position to another,[29] or what is known as "in and out trading."[30] R. Kernweis typically recommended transactions which resulted in positions equaling 50-100% of FPG's net

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engage in the recommended trading strategy that relied heavily on the use of margin. See, e.g., JX-18 at 2, 9, 11, and 16; Tr., March 23, 1999 at 122-123. Within sixty (60) days of withdrawal of the funds from the qualified retirement account, FPG was required to return the funds in order to avoid incurring a tax penalty. Some of the liquidating transactions both in the Sutro IRA Accounts and in the Trading Account were necessitated by the need to generate substantial cash to meet margin calls. JX-18 at 18.

[26] Id.

[27] See, e.g., JXs-6 and 7; Tr., March 23, 1999 at 193; March 24, 1999 at 438, 447.

[28] Tr., March 23, 1999 at 123-124.

[29] Id.; Tr., May 4, 1999 at 916-917. Complainant demonstrated that through the use of margin, the FPG Trading Account, on the advice of R. Kernweis, routinely invested in one speculative security that represented 100% of FPG's liquid net worth. For example, in April 1993, the FPG account held more than $700,000 of Cypress and, in May, the Account held more than $1 million of Cypress. Then, almost immediately after selling Cypress in May 1993, R. Kernweis recommended that FPG purchase more than $1.2 million in warrants of LSI. Immediately after selling LSI, based on R. Kernweis' recommendation, FPG purchased $1.4 million of VLSI. JXs-3, 10 at 9-10; Tr., March 23, 1999 at 123, 125-126, 129-131. The evidence at the Hearing demonstrates that FPG paid approximately $125,000 in gross commissions on the purchase and sale transactions in LSI and VLSI. JX-10 at 21. Although, FPG's profits in these two securities were in excess $200,000 (JX-10 at 17), Complainant demonstrated that this type of continued profitability is unsustainable with this type of trading. In fact, several months later, when R. Kernweis recommended the purchase of large positions in Telefonos and Micropolis warrants, the FPG Trading Account sustained huge losses. The Account incurred purchase and sale commissions of $162,000 (CX-4; JX-10 at 23) and the transactions in these two securities resulted in losses to FPG of more than $475,000 or approximately one-half of FPG's liquid net worth. JX-10 at 10, 11. These costs and losses are only those incurred in FPG's Trading Account. On R. Kernweis' recommendation, FPG also purchased Telefonos and Micropolis for one of his IRA Accounts. JX-4 at 6, 10, 14; JX-10 at 21. The IRA Account paid approximately $47,000 in commissions on the transactions in these two securities and lost approximately $190,000. JX-10 at 21.

worth in a single security.[31] Further, transactions in the Trading Account resulted in an annualized turnover ratio of 26,[32] an annualized cost to equity ratio of 1.5,[33] and an annualized commission to equity ratio of 1.46.[34] During the eighteen month period, the FPG Trading Account incurred total costs in excess of $880,000.[35] The total losses in the FPG Trading Account were $316,000.00.[36]

B. Complainant's Charges

Based on the foregoing, Complainant alleges that the KKS Group made unsuitable recommendations to FPG based on the size, frequency, and number of the recommended

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[30] "In and out trading" is characterized by the sale of all or part of a portfolio, with the cash generated being reinvested in other securities followed by the sale of the newly acquired securities. See Costello v. Oppenheimer & Co., 711 F.2d 1361, 1369, n.9 (7th Cir. 1983).

[31] See, e.g., CX-4; JX-3 at 16-24; Tr., May 4, 1999 at 916-917. Over the eighteen month period, the FPG Trading Account maintained an average monthly portfolio value of $633,718 and an average monthly portfolio equity of $324,706 indicating that the account was highly leveraged. JX-2. These figures also indicate that, on average, FPG was risking approximately 60% of his liquid net worth.

[32] JX-2 at 6; Tr., May 4, 1999 at 907. The turnover ratio reflects the number of times that the equity in the account is turned over. Id. at 904. A turnover ratio of 26 means that, on average, every security in the account was sold once every two weeks. Id. at 907.

[33] JX-2 at 13; Tr., May 4, 1999 at 907-909. The cost to equity ratio essentially is the break even point in the account. It is calculated as the total cost divided by the average monthly equity. A cost to equity ratio of 1.5 means that the equity in the account had to earn 150% in order for FPG to cover the cost of the account. Id.

[34] JX-2 at 1; Tr., May 4, 1999 at 909-910. The commission to equity ratio basically is similar to the cost to equity ratio, except that it excludes margin interest and any account fees. Id. at 909. A commission to equity ratio of 1.46 reflects that the equity in FPG's account would have to return 146% to cover just the costs of the commissions and markups. Id. at 910.

[35] For the eighteen month period, the total commissions for the FPG Trading Account were $707,494. Tr., May 4, 1999 at 909. The gross commissions, markdowns, and sales credits earned by the KKS Group from all activity in the Trading Account for the same period were $882,189. Id. at 912-914. In addition, the KKS Group earned $183,276 and $15,129, respectively, in commissions from FPG's two IRA accounts for a total of $1,080,594. Id. at 914-915. On some occasions, Sutro was charging FPG more than a 5% commission on institutional size trades which was greater than the NASD's markup rule and Sutro's own published rate. Id. at 911-912; JX-17.

[36] Tr., March 24, 1999 at 219; Tr., May 4, 1999 at 919. The total losses in all three Sutro accounts were in excess of $670,000. JX-9.

transactions and engaged in fraudulent and excessive trading in FPG's Trading Account.[37]

Complainant charges that the Defending Respondents knew or should have known of the excessive trading in the FPG Trading Account, the costs generated by such trading, and that such trading primarily was for the purpose of generating commissions.[38] Complainant charges that, pursuant to their designated responsibilities, and as managers, Defending Respondents were in positions to supervise the KKS Group to prevent the unsuitable transactions.[39] Moreover, Complainant contends that Defending Respondents were presented with numerous "red flags" and had actual knowledge of the violative activity.[40]

In addition, Complainant charges that, pursuant to a "special examination" by the New York Stock Exchange ("NYSE") in December 1992 of active trading by the KKS Group, the NYSE found violations of NYSE Rules 342 (Offices-Approval, Supervision and Control) and 405 (Diligence as to Accounts).[41] In response to those findings, Sutro entered into certain undertakings[42] which should have resulted in special supervision of trading by the KKS Group. Complainant charges that these "'heightened supervision' efforts were not reasonably designed to prevent the violative activity because that activity was too profitable."[43]

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[37] Tr., May 4, 1999 at 1003.

[38] Complainant's Opp. at 2.

[39] Complaint at ¶¶24-26.

[40] See, e.g., Tr., May 4, 1999 at 947; Complainant's Opp. at 2.

[41] Complaint at ¶22; JX-22 at 1-3.

[42] Complaint at ¶23; JX-22 at 1-3.

[43] Complainant's Opp. at 2; Tr., May 4, 1999 at 955-956, 967.

C. **Respondents' Defenses**

The Defending Respondents either deny that they failed to take appropriate action to prevent the trading abuses in FPG's Trading Account, or assert that they were not responsible for supervising the activities of the KKS Group.

Respondent Kraus contends that the evidence presented at the Hearing demonstrates that he was not charged with any responsibility either for implementing the undertakings made by Sutro to the NYSE concerning the supervision of the KKS Group or with specific supervision of the KKS Group.[44] He also asserts that Complainant failed to establish that he had actual knowledge of the trading in the FPG Trading Account or that he received any reports that would have disclosed such trading.[45]

Respondent Dieterich contends that, as the compliance officer, he did not have the authority to supervise or control the activities of the KKS Group.[46] Rather, he contends that he only had advisory responsibility in reporting to Sutro's executive committee regarding certain activities of the KKS Group and that he fulfilled that responsibility.[47] Respondent Dieterich also contends that Complainant did not present sufficient evidence that he failed to establish, maintain, or enforce adequate supervisory procedures or that he separately or independently was responsible for developing a system of supervision other than that developed by Sutro's senior management.[48]

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[44] Kraus Motion at ¶3.

[45] Id. at ¶7.

[46] Dieterich Motion at 6.

[47] Id. at 5. See also, id. at 6-8.

[48] Id. at 12.

Respondent Willis argues that he complied with his responsibilities under Sutro's supervisory system, including the special procedures developed for supervising the KKS Group.[49] He contends that he kept Sutro's management, including his direct supervisor, Respondent Kraus, fully informed as to the KKS Group's activities, including the FPG Trading Account. Respondent Willis also contends that Complainant failed to demonstrate that his supervision was not reasonable under all the attendant circumstances and, in fact, that he reasonably supervised the KKS Group by complying with Sutro's Supervisory System.[50]

D. The Hearing

The Parties presented evidence and arguments to the Hearing Panel during an eight day period in March, May, and June 1999.[51] Complainant presented eight witnesses: the Defending Respondents; FPG; George McGough ("McGough"), the Chairman and Chief Executive Officer of Sutro from January 1991 through October 1995;[52] Patricia Richardson ("Richardson"), Assistant Branch Manager from January 1993 through June 1994;[53] Ira Gluck ("Gluck"), currently an NASD Regulation Supervisor and, previously, an NASD Regulation Examiner;[54] and Respondent G. Kernweis. Defending Respondents presented no additional witnesses in support of their respective defenses.

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[49] Willis Motion at 2.

[50] Id. at 19-30.

[51] The Hearing dates were March 23-25, May 4-6, and June 8-9, 1999.

[52] Tr., March 25, 1999 at 595.

[53] Tr., May 4, 1999 at 770.

[54] Id. at 897-898. Mr. Gluck was the lead examiner in the examination which resulted in the filing of the Complaint. Id. at 899.

II. FINDINGS OF FACT AND CONCLUSIONS OF LAW

A. Suitability

During the period that the KKS Group was recommending transactions to FPG, his Trading Account was the KKS Group's most active and largest account.[55] The FPG Trading Account yielded in excess of $800,000 in gross sales commissions and sales credits.[56] Indeed, activity in the FPG Trading Account represented approximately 40% of the KKS Group's total gross production for the period from January-December 1993 and 29% for the period from January-May 1994.[57] This gave the KKS Group considerable financial incentive to perpetuate the recommended trading strategy. Further, as a Group, KKS was one of the highest producers at Sutro.[58]

The evidence demonstrates the following: (1) over the eighteen month period, with the exception of several unsolicited sell orders, all transactions in the FPG Trading Account were recommended by R. Kernweis; (2) the Trading Account was highly leveraged through the excessive use of margin; (3) the average monthly portfolio value and the average monthly equity indicate that, on average, FPG was risking approximately 60% of his liquid net worth; (4) typically, R. Kernweis recommended taking positions equaling 140% of FPG's liquid net worth; and (5) the activities in the Trading Account

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[55] Tr., June 8, 1999 at 1581. In 1993, the FPG Trading Account represented about 10% of the production of the Los Angeles Branch office. Id. at 1611-1612.

[56] JXs 8-10; Tr., May 4, 1999 at 878-880, 888-889, 913-914. Activity in the FPG Trading Account also generated $22,997.45 in margin interest. JX-2.

[57] Complainant's Pre-Hearing Brief at 14; JX-9.

[58] Tr., May 5, 1999 at 1299.

were characterized by large positions in one or more securities at a given time subjecting FPG to an unsuitable amount of concentration risk.

The evidence also demonstrates that FPG was a speculative investor who was willing "to bet the ranch" on an extremely risky trading strategy.[59] In June 1993, at the request of R. Kernweis he signed a "customer awareness" letter[60] which stated:

> (1) I am a speculative stock investor and my sole investment objective is speculation;
> (2) My account may make substantial profits or suffer substantial losses;
> (3) I will buy and sell securities or the same security often and repeatedly;
> (4) I will pay large commissions; and
> (5) If my objective changes at any time, I will notify Sutro in writing.[61]

In fact, Complainant concedes that FPG was a speculative investor.[62] Complainant also concedes that FPG was suitable for some speculative trading if it involved risking a limited portion of FPG's liquid net worth.[63]

FPG spoke with R. Kernweis on a fairly regular basis about the recommended transactions. Although he routinely accepted almost all of R. Kernweis' recommendations,[64] he approved each trade in his Trading Account and reviewed his confirmations and account statements.[65] FPG was impressed with the profits first

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[59] By the end of May 1993, FPG's Trading Account had a net equity value of over $800,000. By the end of June 1993, the account equity was over $1 million. JX-3 at 18, 22. FPG apparently was pleased by these results, since he opened his first IRA account with Sutro in June 1993. JX-4; see also, Tr., March 23, 1999 at 137, 139; Tr., March 24, 1999 at 584, 585.

[60] JX-18 at 6.

[61] Id.

[62] See Complainant's Memorandum In Support of Motion for Partial Summary Disposition at 8.

[63] Complainant's Pre-Hearing Brief at 11.

[64] Tr., March 24, 1999 at 327; Tr., May 4, 1999 at 1031-1032. Except in one instance, FPG accepted all of R. Kernweis' trading recommendations. Even then, however, after a second "strong sales pitch" by R. Kernweis, FPG changed his mind and accepted the recommendation. Willis Ex. 4; Tr., March 24, 1999 at 372, 375.

[65] See, e.g., Tr., March 24 at 363-366, 570-572, 584, 585.

generated by R. Kernweis' trading strategy and came to trust and rely on his representations.[66]

Although FPG attempted to convince the Hearing Panel that he was an "unsophisticated investor," the Hearing Panel did not find his testimony in this respect credible.[67] Moreover, whatever the state of his investment experience at the time he first opened his Sutro Trading Account, the evidence clearly demonstrates that he quickly became extremely knowledgeable as to the investment strategy recommended by R. Kernweis. FPG endorsed and encouraged the perpetuation of trading predicated on purchasing large positions in a single speculative security on margin and on market timing.[68]

The evidence also demonstrates that FPG appeared to understand the risks of the recommended trading strategy.[69] In fact, in June 1993, he wrote to Respondent R.

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[66] See, e.g., Tr., March 24, 1999 at 402.

[67] FPG admitted that he maintained accounts at six different brokerage firms before and during the time he was trading at Sutro and that he invested in speculative stocks, frequently on margin. Tr., May 4, 1999 at 971; March 24, 1999 at 314-15, 425; JXs 13-15A. There was no evidence presented at the Hearing, however, that anyone at Sutro was aware of FPG's other investments at the time he opened or maintained his Trading Account. Thus, although the Defending Respondents spent considerable time at the Hearing addressing these other accounts, they are irrelevant to the findings of the Hearing Panel.

[68] Willis Ex. 4 is comprised of FPG's notes that reflect his conversations with R. Kernweis and his understanding of the recommended transactions. Tr., March 24, 1999 at 358-384. In August and September 1994, FPG prepared detailed and accurate analyses reflecting the performance of his Trading Account. JXs-39 and 40. These analyses reflect a fairly sophisticated understanding of account transactions, costs and results, and FPG's ability to analyze such information. Even though he had sustained substantial losses in his Sutro accounts by this time, the correspondence reflects a desire to continue engaging in a trading strategy based on market timing, and "leveraging up with low priced stocks." JX-39 at 1; JX-40 at 1. There is no evidence that FPG ever complained about the frequency of trading in his account or the extraordinarily high commissions generated as a result of the recommended trading strategy.

[69] The evidence demonstrates that FPG transferred funds from his Sutro IRA accounts to his Trading Account, recognizing that there would be a penalty for doing so. Typically, this was done to meet margin calls in his Trading Account. See, e.g., JX-18 at 13, 17. In addition, from time to time, he also instructed R. Kernweis to sell shares in his Trading Account and transfer the funds back to his Sutro IRA accounts. See, e.g., id. at 2, 9, 11, 16. See also JX-21.

Kernweis thanking him for demonstrating the financial advantages of market timing by "focusing on several large stock issues versus using an indexed approach to the market, i.e., my Merrill Lynch Money Managed Accounts."[70] Even when faced with significant losses in his account, FPG continued to accept R. Kernweis' recommendations and purchase large positions in various securities believing he could recoup his losses through well-timed trades.[71]

Even though FPG was a speculative investor, this did not relieve R. Kernweis of the obligation to ensure that his recommendations were suitable for the client given the client's financial situation, needs, and other security holdings. NASD Conduct Rule 2310 requires that a registered representative, when recommending investments, determine that such investments are suitable for the customer.[72] In the context of this proceeding, the recent decision of the National Adjudicatory Council ("the NAC") in Vaughan is particularly instructive. There the NAC stated --

> A broker must make a customer-specific determination of suitability, and he or she must recommend only those securities that fit the customer's financial profile and investment objective. * * * The broker must make recommendations based on the information he or she has about the customer, rather than on speculation. * * * [citations omitted][73]

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[70] JX-18 at 2.

[71] See, e.g., JX-25 at 2.

[72] District Business Conduct Committee No. 7 v. Vaughan "(Vaughan"), Complaint No. C07960105 (Oct. 22, 1998). Even though all the trades were approved by FPG, the Hearing Panel finds that Respondent Kernweis had control over trading in the FPG Account. Respondent Kernweis solicited all but a few liquidating sales transactions and all his recommendations were accepted by FPG. Control is established where a customer, although not granting a broker a formal power of attorney, so relies on the broker that the latter is in a position to control the volume and frequency of trading in the account. In re John M. Reynolds ("Reynolds"), Exchange Act Rel. No. 30036, 50 S.E.C. 805, 1991 SEC LEXIS 2725 (Dec. 4, 1991). That is the exact situation here.

[73] Vaughan at 5.

Further, as relevant here, the NAC noted that even a purported sophisticated investor, who enjoys and encourages trading in speculative securities, is entitled to the protections of NASD Conduct Rule 2310. The NAC stated that "[a] customer's prior transactions * * * are not relevant in a suitability determination, and [a] history of risky trading [does not] mitigate [respondent's] conduct."[74]

> Even if [respondent] had explained the risks to [the customer], the securities he recommended for her account would still have been unsuitable. The SEC has made clear that even in those situations where a customer seeks to engage in highly speculative or otherwise aggressive trading, a representative is under a duty to refrain from making recommendations that are incompatible with the customer's financial profile. (citations omitted).[75]

The Hearing Panel finds that the FPG Trading Account, characterized by large positions in one or two speculative securities, was subject to an unsuitable concentration risk, resulting in positions equaling as much as 140% of FPG's liquid net worth. The Hearing Panel also finds that the FPG Trading Account was excessively traded since the annualized minimum rate of return necessary to cover the annual account costs was 150%. Further, the turnover ratio for the FPG Trading Account was 26.1, which means that, on average, every stock in the portfolio was sold every two weeks. As the SEC has noted, "[t]here is a difference between aggressive investing and excessive trading."[76] An

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[74] Id. at 6.

[75] Id. at 7.

[76] In re Shearson Lehman Hutton Inc., Exchange Act Rel. No. 26766, 49 S.E.C. 1119, 1989 SEC LEXIS 778, at *6 (April 28, 1989). In Shearson Lehman, the SEC found excessive training where the turnover rate was 7.4. Id. at *7.

investment objective of speculation does not excuse excessive trading.[77] "The NASD regards excessive trading as a violation of its 'suitability rule.'"[78]

Even if FPG appreciated at least some of the risks of the trading strategy recommended by R. Kernweis,[79] the Panel finds that he financially was unable to bear the risks associated with frequent purchases and sales of large amounts of speculative stocks on margin at the extraordinary high trading costs attendant to the recommended trading strategy. The Panel finds that regardless of FPG's apparent endorsement of, and enthusiasm for, the recommended speculative investment strategy,[80] R. Kernweis had a duty to recommend investments that did not risk FPG's entire net worth.[81] As the SEC noted in a similar context,

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[77] Id. at *6.

[78] In the Matter of the Application of Michael H. Hume ("Hume"), Exchange Act Rel. No. 35608, 52 S.E.C. 243, 1995 SEC LEXIS 983, *5 (April 17, 1995). As the Association has noted "excessive trading clearly violates a broker's responsibility of fair dealing * * *." Id. at *5 n.5. See also IM-2310-2(b)(2).

[79] In response to the NASD's "Excessive Trading Investigation Customer Interview Checklist," FPG represented that he had no difficulty understanding his account statements and that when he had questions, he discussed them with R. Kernweis. JX-10 at 6.

[80] Even though it is undisputed that FPG was consulted prior to and approved each transaction in his account, and received and reviewed confirmations and monthly account statements, this does not preclude a finding of excessive trading. See Hecht v. Harris, Upham & Co., 283 F. Supp. 417, 434 (N.D. Cal. 1968); cf. Follansbee v. Davis, Skaggs & Co., 681 F.2d 673 (9th Cir. 1982). Follansbee involved a customer with an investment strategy based on frequent trading and market timing who sued his broker for churning and making unsuitable recommendations. The court held the customer was suitable for that type of trading stating that such a strategy is acceptable as long as "the customer has sufficient intelligence and understanding to evaluate the broker's recommendations and to reject one when he thinks it unsuitable." Id. at 677. In that case, however, unlike the situation presented here, on certain occasions, plaintiff declined to follow the broker's recommendations and generated suggestions for further investigation. He also conducted his own analysis of financial reports and materials and made an investment in a tax-sheltered limited partnership against his broker's advice, misstating his income tax situation to convince his broker to handle the investment. Id. at 675, 678. Further, there is a difference between a disciplinary proceeding and a private action for damages. It may well be that FPG also was at fault and could not recover in a suit for damages. The focus of a disciplinary proceeding, however, is the conduct of the registered representative.

[81] The fact that FPG had accounts at other firms, does not mitigate R. Kernweis' conduct. No evidence was presented at the Hearing that R. Kernweis or anyone at Sutro knew of these other accounts nor were they disclosed on Sutro's new account forms. In fact, on each of FPG's Sutro account forms, a "no" is checked in response to the question "[d]oes client have an account with another brokerage firm." JXs-3-5. The suitability rule encompassed by NASD Conduct Rule 2310 requires the making of recommendations based

> Whether or not the [customers] ultimately considered * * * [the] transactions appropriate is not the test for determining the propriety of [Respondent's] conduct. Having undertaken to act as an investment counsellor (sic) * * *, [Respondent] was required to make only such recommendations as were in their best interests. [citations omitted][82]

Even though FPG appears to have authorized R. Kernweis to manage his account aggressively, FPG did not authorize R. Kernweis to deplete his account through unsuitable and excessive trades, commissions, markups, and margin charges. Further, he could not authorize R. Kernweis to make unsuitable recommendations.[83] Based upon FPG's financial situation, the frequency and exorbitant cost of the trading, and the excessive risk caused by highly leveraged and concentrated positions resulting from the recommended investment strategy, the Hearing Panel finds that R. Kernweis' recommendations to FPG were unsuitable as alleged in the First Cause of Complaint in violation of NASD Conduct Rules 2110 and 2310.[84]

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on facts known by the registered representative, including the customer's financial situation and investment experience. Further, the evidence demonstrates that most of FPG's prior investment experience involved his retirement funds which were managed professionally. JX-10 at 4.

[82] In re Clyde J. Bruff, Exchange Act Rel. No. 31141, 50 S.E.C. 1266, 1992 SEC LEXIS 2197, at *9-10 (Sept. 3, 1992); See also In re Gordon Scott Venters, Exchange Act Rel. No. 31833, 51 S.E.C. 292, 1993 SEC LEXIS 237 (Feb. 8, 1993); Reynolds, 1991 SEC LEXIS 2725, at *11("As a fiduciary, a broker is charged with making recommendations in the best interests of his customer even when such recommendations contradict the customer's wishes.").

[83] In Vaughan, the NAC made clear that even if the customer instructed respondent to purchase the recommended speculative securities, such instructions would be irrelevant to a suitability determination. Id. at 7. See also In re Eugene J. Erdos, Exchange Act Rel. No. 20376, 47 S.E.C. 985, 1983 SEC LEXIS 332, at *11-12 (Nov. 16, 1983)("Even assuming that Mrs. C's objective was to make quick profits, the activity in her account was clearly excessive in light of her financial situation. And the fact that Mrs. C may have authorized the transactions in her account does not alter that conclusion. As we have seen, Mrs. C did not initiate the transactions, but relied on and followed Erdos' recommendations.").

[84] For purposes of this Decision only, with respect to the Defending Respondents, the Hearing Panel finds it unnecessary to reach a decision as to the violations alleged in the Second and Third Causes of Complaint.

B. Supervision

1. General Findings

The essence of the claims against the Defending Respondents is that they knew or should have known of the unsuitable recommendations made to FPG and that, as managers, they had the authority and obligation to supervise the KKS Group to prevent the excessive trading in the account of FPG.[85] The Defending Respondents all were aware of the NYSE "Special Examination" in December 1992. The NYSE staff examiner expressed serious concerns about the KKS Group's recommended investment strategy to its customers, the level of active trading done by the KKS Group, and that it traded primarily for commissions and not for the benefit of the client.[86]

In response to the NYSE's concerns, in August 1993, Respondent Sutro represented to the NYSE that the Firm, the branch manager, and the KKS Group had taken "the following steps * * * to ensure that there is no question of suitability or excessive trading in these accounts:

- The KKS Group is documenting all discussions with their customers during which they have encouraged those customers to diversify their trading account.
- The branch manager is to review all accounts with the KKS Group every four to six weeks with an eye on suitability and, if appropriate, diversification.
- The firm is monitoring the KKS accounts with regard to commissions vs. profitability.

[85] Complaint at ¶¶25-26.

[86] JX-22 at 1-3; Tr., May 4, 1999 at 795-796; Tr., June 8, 1999 at 1590. The NYSE's review of seven active accounts concluded that the trading was excessive and designed to maximize the commissions/credits for the benefit of the KKS Group. The FPG Trading Account was not opened at the time of the 1992 NYSE Special Examination. G. Kernweis testified that the KKS Group was not made aware of results of the NYSE Special Examination until the Fall of 1993 when it was asked to prepare client information "bios" for a NYSE follow-up visit. Tr., May 6, 1999 at 1341-1342, 1402-1403.

- The KKS Group has received special training by Sutro in the area of mutual funds and annuities."[87]

In response to an April 3, 1998 NASD staff inquiry as to the individuals responsible for implementation of the Sutro undertakings to the NYSE, then Sutro Chairman and Chief Executive Officer McGough represented that:

- The three registered representatives of the KKS Group * * * were responsible for documenting all client discussions. The oversight of these activities and related records was the responsibility of the branch manager, William Willis, and the assistant manager, Patricia Richardson;
- The branch manager and the assistant branch manger were responsible for the second initiative;
- I believe that the branch manager was primarily responsible for the third initiative;
- The fourth initiative was to be arranged by the branch manager, but the actual product training was to be conducted by one or more of Sutro's product specialists.[88]

There was conflicting evidence presented at the Hearing regarding whether Sutro complied with its undertakings to the NYSE. For example, there is no evidence that the KKS Group documented its discussions with customers encouraging them to diversify or that it was instructed to do so.[89] With respect to the second and third undertakings, while Respondent Willis appears to have met with the KKS Group several times between May

[87] JX-22 at 4-5.

[88] JX-22 at 8-9.

[89] Tr., May 4, 1999 at 957, 958. Respondent G. Kernweis testified that in the May, June, and July 1993 time period, the KKS Group was not told to diversify its product mix or to change its business. Tr., May 6, 1999 at 1345-13466. The documents, however, suggest otherwise. See, e.g., JX-28 at 4, 10, 16. G. Kernweis, testified that much later, in the Fall of 1993, after the KKS Group was told of the NYSE audit (Tr., May 6, 1999 at 1341-1342), it was suggested that it would be a good idea to diversify its customers' product mix, but it never specifically was instructed to do so and, in fact, with the exception of the recommendation of bonds to a handful of customers, never did. Id. at 1348-1350, 1396, 1413; see also id. at 1388, 1389. Respondent G. Kernweis testified the KKS Group did not document any conversations with customers where it solicited bonds. Id. at 1350. This testimony is inconsistent with statements set forth in his Answer to the Complaint. Id. at 1367.

and September 1993, to discuss generally the status of various accounts,[90] there is no evidence to suggest that there was a focus on suitability, excessive trading, or commissions versus profitability.[91] As to the fourth undertaking by Sutro to the NYSE, Complainant concedes that the KKS Group received special training in the area of mutual funds and annuities.[92]

The NYSE returned to Sutro in December 1993 to review the KKS Accounts. Respondents Willis and Dieterich, and Ms. Richardson, the Assistant Branch Manager, attended that meeting with the KKS Group.[93] According to G. Kernweis, in advance of that meeting, Respondent Willis instructed him to complete an NYSE pre-examination questionnaire so it would appear that the KKS Group's trading was diversified.[94]

In addition, a new customer form for a second Sutro IRA account, completed in late November 1993, still reflected that FPG's gross income was $100,000 "plus" and his net worth was $1 million "plus."[95] Respondent Willis and G. Kernweis, however, both testified that prior to the meeting with the NYSE they understood that FPG had a gross income of $300,000 and a net worth of $3 million.[96] In fact, in a memorandum to the

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[90] Tr., May 4, 1999 at 796-797, 959-960; see JX-28 at 4, 7-8, 10-11, and 14-15. JX-28 is comprised of four (4) memoranda from Respondent Willis to Respondent Kraus documenting his meetings with the KKS Group and the matters discussed.

[91] Id.; Tr., May 4, 1999 at 801-02.

[92] Tr., May 4, 1999 at 962. See also id. at 861-862.

[93] Id. at 805-806.

[94] Tr., May 6, 1999 at 1416-1417; see also id. at 1378-79, 1392-1393, 1447.

[95] JX-5 at 1; see also, Tr. June 8, 1999 at 1643-1644.

[96] G. Kernweis testified that he learned this information from his brother, R. Kernweis during the preparation of the client "bios" and, also, from Respondent Willis. Tr., May 6, 1999 at 1451, 1484-1485. Respondent G. Kernweis admitted he had no idea where these numbers came from. Id. at 1460. Respondent Willis testified that he obtained this information from R. Kernweis. Tr., June 8, 1999 at 1606-1607, 1640-1642. Respondent Kraus and Ms. Richardson also testified that they understood FPG to have a net worth over $3 million but, like many wealthy investors, FPG did not want to disclose the full extent of his assets.

NYSE staff examiner, Respondent Willis represented that FPG's net worth was in excess of $3 million, with $2 million liquid and a net income of $300,000 per year.[97]

No evidence was presented at the Hearing whether the NYSE staff examiner, who was deceased, reached any final conclusions regarding the trading in the KKS Group's accounts at the meeting in December 1993. It is undisputed that in the meeting with the KKS Group, the NYSE staff examiner expressed the view that trading in the KKS Group's customers' accounts was excessive[98] and, specifically, expressed a concern that the KKS Group generated "more commission than the client makes in profit."[99] According to the notes of that meeting, he stated –

> Based on my review, I feel you trade first for commissions and second for the client. Yes, a rule violation. I have never seen anything worse in my life.[100]

Ms. Richardson and Respondent Willis testified, however, that following the meeting at which the KKS Group was present, the staff examiner met with Respondent Willis in his

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Tr., May 4, 1999 at 864; Tr., May 6, 1999 at 1555. Respondent Kraus testified that he had no idea where the $3 million figure came from other than what Respondent Willis told him; "[m]y inference was because he had spoken to the client, he knew it was $3 million." Id. at 1556.

[97] JX-28 at 24; Tr., June 8, 1999 at 1641-42.

[98] The FPG Account was the focus of discussion at the December 1993 meeting with the NYSE. According to both G. Kernweis and Respondent Willis, the NYSE staff examiner initially expressed the view that the activity in the FPG Account was excessive and that the Group was trading for purposes of generating commissions as opposed to the investment interests of the customers. Tr. May 6, 1999 at 1487-1488; Tr., June 8, 1999 at 1652. Later, the KKS Group was told by Sutro that their accounts were fine and that, with respect to the FPG Account, the staff examiner understood the "activity being reflective of the profit and it wasn't a problem." Tr., May 6, 1999 at 1489. See also, Tr., May 4, 1999 at 807.

[99] JX-43 at 18. JX-43 are notes taken by Ms. Richardson during the meeting with Tom Ruddy ("TR"), the NYSE staff examiner. Tr., May 4, 1999 at 805. According to her notes, TR stated "[y]ou have the same problem as last year, I see no improvement." JX-43 at 20.

[100] JX-43 at 21.

office, reviewed certain documents, and was very complimentary with respect to management of the Branch.[101]

2. Findings As To Respondent Willis

During the relevant period, Sutro's Los Angeles Branch Office fluctuated between 14 and 32 registered individuals, all supervised by Respondent Willis and two assistant managers.[102] Respondent Willis' job functions were the daily supervision of AEs and the trading activity. His responsibilities also included recruiting, serving as sales manager, and ensuring compliance with Firm and industry regulations. He was required to review trades, trade blotters, order tickets, new account forms, incoming and outgoing correspondence on a daily basis, monthly statements on a quarterly basis, and the Firm's monthly account surveillance reports. When potential problems, questions, or areas of concern arose, Respondent Willis was responsible for discussing the issue with the particular AE and, in some cases, with the client directly.[103]

Respondent Willis was the KKS Group's direct supervisor and was aware of its recommended investment strategy, both as to FPG and its other customers.[104] Respondent Willis also knew that FPG was the KKS Group's most active account and that it generated commissions far in excess of any other account.[105] In fact, as Branch Manager, he reviewed each trade, signed each transaction ticket, and reviewed account

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[101] Tr., May 4, 1999 at 807-813, 882-884; Tr., June 8, 1999 at 1654, 1666-1668. In addition, Respondent Dieterich's notes reflect that the NYSE staff examiner thought Respondent Willis' supervision of the Branch was more than adequate and that "'Willis is a very good manager.'" JX-43 at 22. Similarly, Respondent Dieterich's notes of the exit interview with the NYSE reflect that the examiner thought the Firm finally was supervising the KKS Group properly. JX-43 at 27; Tr., May 5, 1999 at 1265.

[102] Tr., May 4, 1999 at 873; Tr., June 8, 1999 at 1575-76, 1658.

[103] William Pohn Willis' Motion For Summary Disposition at 12; see also Tr., May 4, 1999 at 785.

[104] Tr., June 8, 1999 at 1578.

statements and surveillance reports.[106] Yet, the evidence demonstrates that he did not question either the size or the frequency of the trades or refuse to sign any trading tickets brought to him for approval.[107]

a. Contacts with FPG/active account review

The evidence demonstrates that Respondent Willis spoke with FPG on three occasions. According to the Active Account Information Report ("the Information Report"), Respondent Willis first spoke with FPG on October 4, 1993, after the Trading Account had been actively trading for more than eight months, had appeared on Sutro's active account reports for six months, and, after making substantial gains, had declined in value. He spoke with FPG again on April 9, 1994, after the account value had decreased substantially in value. Respondent Willis' third and final conversation with FPG was on August 18, 1994, after R. Kernweis left Sutro.[108]

Sutro's own procedures require that the Branch Manager review the Firm's Surveillance Reports for active accounts,[109] and that the Branch Manager make personal

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[105] See, e.g., Tr., June 8, 1999 at 1611-1612.

[106] Tr., May 4, 1999 at 785-786; Tr., May 6, 1999 at 1475; Tr., June 8, 1999 at 1600-1602.

[107] Tr., May 6, 1999 at 1475. Although there was testimony presented at the Hearing that Respondent Willis had almost daily conversations with members of the KKS Group about what they were doing (Tr., May 6, 1999 at 1343), there is no evidence that he ever questioned or disapproved a trade. Id. at 1337-1338.

[108] Joint Stipulation at ¶10; JX-25. Respondent Willis and Ms. Richardson testified that there must have been other conversations with FPG which are not reflected in the Information Report. Tr., May 4, 1999 at 837-838; Tr., June 8, 1999 at 1629-1631. In addition, Respondent Willis left messages for FPG on or about September 29, 1993, October 4, 1993, and December 14, 1993. Id. The last call, August 18, 1994, is not within the relevant time frame of the alleged violations. Thus, Respondent Willis only spoke with FPG twice during the eighteen month period when his account was being actively traded.

[109] JX-24 at 14. JX-24 is a memorandum from Respondent Dieterich to all Branch Managers dated March 27, 1993 entitled "Procedures for Reviewing Account Surveillance Reports" ("the Procedures"). When an account appeared on the Surveillance Report, the AE was to complete a portion of the Information Report, there was to be an in-depth discussion of the account between the Branch Manager and the AE, and the Branch Manager was to make personal contact with the client. Id. The bottom section of the Information Report was to be used to document the client meeting or conversation. Id. The responsibility for active

contact with a customer who appears on such Report.[110] In addition, Sutro's Compliance Manual requires prior approval of the Branch Manager for all orders to buy or sell 5,000 shares or more or involving $50,000 or more.[111]

The FPG Trading Account first appeared on the Surveillance Report in April 1993[112] and appeared every month thereafter.[113] Yet, Respondent Willis first spoke to FPG in October 1993.[114]

Respondent Willis' own notes of his conversations with FPG demonstrate that the two documented phone calls were "perfunctory."[115] There is no evidence that Respondent Willis discussed with FPG his financial situation and needs, income, net worth, or other security holdings.[116] Moreover, Respondent Willis did not discuss any specific transactions, including those that had generated significant losses, the excessive costs of

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account review was delegated to Ms. Richardson. Tr., May 4, 1999 at 773, 831; Tr., June 8, 1999 at 1623. Ms. Richardson testified that when she determined an account was active, she coordinated completion of the Information Report with the AE and then gave it to Respondent Willis for review. Id. at 776-777, 831.

[110] JX-24 at 14. JX-24 provides that "[i]f the Branch Manager deems the personal contact * * * to be unnecessary or inappropriate, he may at his discretion and after appropriate notice to the Compliance Department institute substitute procedures." Id. at 15. See also Tr., May 5, 1999 at 1197, 1248-1249. Although there was testimony that there was more flexibility than provided for by the Procedures (Tr., May 4, 1999 at 818-820, 823-824; Tr., May 5, 1999 at 1196-99), there is no evidence that Respondent Willis notified the Compliance Department that he was instituting substitute procedures for the FPG Trading Account. Id. at 1249-1250.

[111] JX-27 at 89. Since most of the transactions in FPG's Trading Account exceeded these limits, if Respondent Willis followed these procedures, it should have been obvious that the recommended investment strategy was unsuitable for almost any investor.

[112] JX-26 at 2.

[113] JX-26. Ms. Richardson testified that she did not find it necessary to flag the FPG Trading Account as an active account or generate an Information Report prior to June 14, 1993 for the period ending March 28, 1993 and that she made this decision in consultation with Respondent Dieterich. Tr., May 4, 1999 at 779-780, 783-784.

[114] JX-25; Tr., June 8, 1999 at 1629.

[115] JX-25.

[116] Indeed, Respondent Willis admitted that he did not inquire as to these matters. Tr., June 8, 1999 at 1645-1647. Rather, he relied on what R. Kernweis told him. Id.

the Account, or the high risk trading strategy in which FPG was engaged.[117] Indeed, although the April 1994 call was triggered by substantial losses that obviously affected FPG's net worth,[118] Respondent Willis did not inquire about his financial situation.

Respondent Willis contends that during these conversations he satisfied himself that FPG had a firm grasp of the market and his trading, that he was sophisticated, that he continued to want to engage in speculative trading despite losses, and that he generally was "happy" with the trading strategy.[119] Determining, however, that the client may have a firm grasp of the market, be "happy," or wish to continue with a high risk trading strategy is not equivalent to an appropriate suitability determination. A suitability determination is not predicated on what a customer may want. Rather, NASD Conduct Rule 2310 requires that the determination be made on the basis of the customer's other investments and his financial situation and needs. Respondent Willis' own notes of his conversations with FPG reflect that questions appropriate to such a suitability determination never were raised.[120]

Further, certain instructions that FPG gave to R. Kernweis concerning his accounts were a "red flag" that FPG had certain liquidity problems and was required to use tax-sheltered retirement funds to cover losses in his Trading Account. Indeed, as early as June 1993, FPG informed Respondent R. Kernweis that "[d]ue to liquidity

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[117] See, e.g., Tr., June 8, 1999 at 1678. Rather, Respondent Willis asked whether FPG had received his confirmations and understood them, whether he understood how much his account was "down," and whether he knew how to read his account statements. Id. at 1648-49. He also inquired whether FPG knew he was paying a lot in commissions and whether he was aware of the transactions. Id. at 1631.

[118] At the end of April 1994, the Account equity was less than $150,000. JX-3 at 64. At the end of June 1994, the last month that the KKS Group was FPG's AE, the Account equity was approximately $82,000. Id. at 70.

[119] Tr., June 8, 1999 at 1649; JX-25.

[120] JX-25. See also Tr., June 8, 1999 at 1629, 1647-1648.

concerns both from a personal and family standpoint, I do not anticipate making any further significant financial additions to my Sutro account at this time."[121] And in September 1993, FPG instructed Respondent R. Kernweis to sell 28,000 shares in one of his Sutro IRA accounts and transfer $150,000 of the proceeds of the sale to his Trading Account.[122] Even though Respondent Willis knew of these communications, and knew that FPG was liquidating an IRA account to transfer funds to his Trading Account,[123] he did not inquire as to his current financial situation. He did not inquire as to the need to use tax-deferred money to cover losses in the Trading Account and then to sell such stock at a loss in order to transfer funds back to the Sutro IRA Account to avoid adverse tax consequences.[124]

b. Meetings with the KKS Group

During the relevant period, Respondent Willis also held meetings with the KKS Group, apparently to satisfy the undertakings made by Respondent Sutro to the NYSE. Respondent Willis testified that he was aware of the problems with the KKS Group's trading strategy, and was instructed by McGough to meet with the members every four to six weeks to review active trading in their customer accounts.[125] Respondent Willis

[121] JX-18 at 2. Even though he reviewed this letter, Respondent Kernweis testified that it did not raise any questions or concerns about whether FPG was worth $3 million as had been represented to him by R. Kernweis. Tr., June 8, 1999 at 1613.

[122] JX-18 at 13. This transfer was required because of a substantial margin debit in the Trading Account. JX-3 at 36-37. See also Tr., March 23, 1999 at 193. FPG sent other letters to R. Kernweis instructing him to move money between his Trading Account and his Sutro IRA accounts. JX-18 at 5, 9, 11, 16, 17.

[123] Respondent Willis testified that the transfer of IRA funds to the Trading Account did not raise any concerns about FPG's net worth. Tr., June 8, 1999 at 1618.

[124] Tr., June 8, 1999 at 1614, 1620, 1647. The correspondence makes clear that FPG recognized that such transactions might appear "nonsensical," but that they were being done for tax considerations. JX-18 at 16.

[125] Tr., June 8, 1999 at 1589-1595. Not only was Respondent Willis present during the December 1992 NYSE examination when concerns were raised that the KKS Group was trading for commissions and not

testified that, because the Firm expected the NYSE to return for its annual audit at the end of 1994, it was appropriate to heighten supervision of the KKS Group.[126]

Four meetings with the KKS Group are documented in a series of memoranda from Respondent Willis to Respondent Kraus from May 1993 through September 1993.[127] Respondent Willis testified that the purpose of the meetings was to review the KKS Group's active accounts and also diversification of its clients and product mix.[128]

Respondent Willis argued that, by virtue of these meetings with the KKS Group, and the memoranda generated thereby, he kept Sutro's management, including the compliance department, informed of the activities of the KKS Group, including activity in the FPG Account. Respondent Willis submits that he thereby fulfilled his assigned responsibility with respect to the undertakings made to the NYSE by communicating all necessary information to enable Sutro to decide how to handle the FPG Account.[129]

The memoranda reflect that Respondent Willis was fully aware of the need for the KKS Group to diversify its customers' accounts. As early as May 25, 1993, he represented that he told the KKS Group that "they must change their business."[130] With respect to the FPG Account particularly, in a June 10, 1993 memorandum, Respondent Willis, based on what he was told by the KKS Group, represents --

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for the benefit of the clients (id. at 1590), but he testified that both McGough and Respondent Dieterich discussed with him the concerns raised by the NYSE staff examiner. Id. at 1592.

[126] Tr., June 8, 1999 at 1591-93.

[127] JX-28 at 4, 6-8, 10-11, 14-16; Tr., June 8, 1999 at 1594. As these memoranda demonstrate, the subject of these meetings was not the FPG Trading Account, but all active accounts being handled by the KKS Group.

[128] Tr., June 8, 1999 at 1594-1595.

[129] Respondent Willis' Motion for Summary Disposition at 16.

[130] JX-28 at 4.

> [FPG]: Expecting $300M with 125M arriving next week; will diversify account when VLSI is sold.[131]

Similarly, in a September 29, 1993 memorandum to Respondent Kraus, Respondent Willis stated:

> [FPG]–He has doubled his money; currently invested in one stock, MLIS. He is still not interested in diversifying his account, however, KKS will continue to try diversification. Their goal is to have him [in] at least three stocks.[132]

And in memoranda dated July 29, 1993 and September 30, 1993, Respondent Willis represented that the KKS Group was soliciting its customers to invest in bonds and that such communications have been documented.[133]

There is no evidence, however, that the KKS Group seriously attempted to diversify its customers' accounts or that it documented such solicitations. In fact, with the exception of an isolated fund which was recommended to a few clients, the evidence is to the contrary.[134] There is no evidence that Respondent Willis ever prevented the KKS Group from continuing its trading strategy.[135]

As to FPG there is no evidence that Respondent Willis attempted to stop the unsuitable recommendations. FPG did not diversify his account and there is no evidence

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[131] JX-28 at 7; Tr. June 8, 1999 at 1660, 1671-1672. Respondent Willis admitted that, to his knowledge, an additional $125M did not come into the account as expected nor was the account diversified when the VLSI stock was sold because FPG did not want to do so. Id. at 1672.

[132] JX-28 at 14.

[133] Id. at 10, 16.

[134] Tr., May 6, 1995 at 1335-1346, 1349-1350, 1386-1389, 1447, 1449.

[135] Respondent Wills testified that at one time in 1993, before the FPG Account became very active, and in response to information that the NYSE was going to write up its December 1992 findings concerning trading by the KKS Group, he asked McGough whether the KKS Group should be terminated and McGough responded "Not now." Tr., June 8, 1999 at 1662, 1673, 1682-1683. Respondent Willis also testified, however, that he never raised the issue of closing down the FPG Account (id. at 1681) nor is there any evidence that he ever raised the issue of terminating the KKS Group again.

that Respondent Willis did any follow-up in this respect. Further, Respondent Willis' memoranda regarding his meetings with the KKS Group, as well as his own testimony, clearly demonstrate that there was no discussion of the commissions generated by the Trading Account or the cost to FPG from the trading activity, which evidences that there was no monitoring of commissions versus profitability.[136]

c. Findings pursuant to NASD Conduct Rule 3010

The legal standard for application of NASD Conduct Rule 3010 is reasonable supervision which is to be determined on the particular facts of each case.[137] The SEC has held that "[a] failure to supervise can arise where a supervisor was aware only of 'red flags' or 'suggestions' of irregularities" and that "[u]nder such circumstances a supervisor cannot discharge his or her supervisory obligations simply by relying on the unverified representations of employees."[138] As the SEC recognized,

> supervisory obligations * * * require a vigorous response even to indications of wrongdoing. * * * 'There must be adequate follow-up and review when a firm's own procedures detect irregularities or unusual trading activity * * *.' [citations omitted][139]

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[136] Tr., June 8, 1999 at 1631, 1634, 1635-1636, 1678. Respondent Willis admitted that he knew the FPG Trading Account generated substantial commissions. Id. at 1612.

[137] In the Matter of Benz ("Benz"), Exchange Act Rel. No, 38440, 52 S.E.C. 1280, 1997 SEC LEXIS 672, at *12 (March 26, 1997). In Benz, the SEC upheld the NASD's findings that respondent had failed adequately to supervise a registered representative. Respondent argued that he did not have the authority to hire and fire all employees in the Los Angeles Branch office. Id. There is no such evidence here. In fact, the evidence is to the contrary. See also In re Philadelphia Investors ("Philadelphia Investors"), Exchange Act Rel. No. ID-123, 1998 SEC LEXIS 466, at *35 (March 20, 1998).

[138] Hume, 1995 SEC LEXIS 983 at *12.

[139] In the Matter of John H. Gutfreund, Exchange Act Rel. No. 31554, 51 S.E.C. 93, 1992 SEC LEXIS 2939, at *35 (Dec. 3, 1992); see also Philadelphia Investors, 1998 SEC LEXIS 466 at *45.

Further, the SEC has noted that "[l]iability for failure to supervise may be imposed when a supervisor '[fails] to learn of improprieties when diligent application of supervisory procedures would have uncovered them.'"[140]

This is not a typical failure to supervise case where a branch manager wholly failed to supervise a broker, failed to implement some form of necessary heightened supervision, or failed to keep his supervisors generally informed about the broker's trading activities. Nevertheless, as Branch Manager, and under these particular facts, Respondent Willis should have done more.

Respondent Willis had the authority and the obligation to instruct the KKS Group to stop making unsuitable recommendations, to terminate the KKS Group, or to tell customer FPG that, if he wished to continue to engage in speculative trading, such trading would need to be on an unsolicited basis. Although Respondent Willis knew about the continued excessive trading activity in the FPG Trading Account, he failed to respond adequately to eliminate the problem.[141] It was not reasonable or appropriate for Respondent Willis to rely on the unverified representations of R. Kernweis that FPG had a net income in excess of $3 million, especially given Sutro's own documentation in this respect and FPG's need to cover losses in his Trading Account by transferring funds from his IRA Accounts.

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[140] In re Scudder Investments, Inc.("Scudder Investments), Investment Act Rel. No. 24218, 1999 SEC LEXIS 2737, *18 (December 22, 1999).

[141] The cases relied upon by Respondent Willis are not relevant. Willis' Motion at 13. In Wasnick v. Refco, Inc., 911 F.2d 345, 349 (9th Cir. 1990), the court held that there was no suitability doctrine under Washington state law where a customer's account is discretionary. In Leib v. Merrill Lynch, 461 F. Supp. 951, 956 (E.D. Mich. 1978), plaintiff sued the broker for excessive trading, i.e., churning, claiming that the broker breached his fiduciary duty by allowing plaintiff to pursue an unprofitable pattern of trading. There was no discussion at all of the doctrine of suitability. Moreover, whether or not a customer prevails on a private cause of action against a broker under common or state law does not relieve registered representatives and member firms from compliance with the NASD rules and regulations.

As the Branch Manager, Respondent Willis was required to prevent violations of the securities laws, including NASD Conduct Rule 2310, to the extent he knew such violations were occurring. Yet, the evidence presented at the Hearing demonstrates that Respondent Willis did not follow Sutro's own procedures in supervising the KKS Group and did not instruct the KKS Group to stop making unsuitable recommendations to FPG.[142] These recommendations exposed more than 100% of FPG's liquid net worth to the risk of total loss and resulted in an astronomically high cost to equity ratio. Indeed, under these circumstances, one of Respondent Willis' obligations as Branch Manager was to inquire if FPG realized how much of his funds were being consumed by commissions.[143]

Further, under the circumstances of this case, it was not sufficient for Respondent Willis simply to notify his superiors of the KKS Group's trading activity or to confirm that FPG wished to continue to engage in high risk speculative trading. And, merely confirming that FPG was receiving his account statements and his confirmations which disclosed the commissions, and that he was authorizing the transactions is not a substitute for appropriate supervision.

Based on the foregoing, the Hearing Panel finds that Respondent Willis violated NASD Conduct Rules 2110 and 3010 by failing to take appropriate action to supervise the KKS Group adequately with respect to the FPG Account.

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[142] See, e.g., In re Bradford John Titus, Exchange Act Rel. No. 38029, 52 SEC 1154, 1996 SEC LEXIS 3341 (December 9, 1996).

[143] See, e.g., Hume, 1995 SEC LEXIS 983, at *12. In Hume, the branch manager was found not to have properly supervised the account at issue. Although he had enough red flags to compel him to investigate further, he did not do so. Specifically, the SEC noted "Hume's account demonstrates that he did not react with sufficient concern to his own alarms. He never * * * asked [the customers] if they realized that so much of their funds were being consumed by commission." Id. The same is true here.

3. Findings As To Respondent Dieterich

Respondent Dieterich was the Firm's Director of Compliance. His responsibilities were to manage the Compliance and Registration Departments and to ensure that the Firm was in compliance with the rules and regulations of the securities industry and with Firm policies.[144] Specifically, on a day-to-day basis, he had responsibility for discretionary account review, advertising reviews, writing policies and procedures for Sutro, and managing the compliance staff with respect to activity that was conducted by the Firm.[145] One of the responsibilities of the Compliance Department was active account review.[146] With respect to the KKS Group, McGough specifically requested Respondent Dieterich to "keep an eye on KKS"[147] and, also, to stay on top of the KKS Group's activity.[148]

a. Supervision of the KKS Group

Complainant contends that Respondent Dieterich had more than sufficient information to know of the excessive and unsuitable trading in the FPG Account and, that pursuant to his designated responsibilities, he was in a position to supervise the KKS

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[144] Tr., May 5, 1999 at 1189; JX-23 at 2.

[145] Id. at 1189-90.

[146] Complainant's Opp. at 14.

[147] Tr., May 5, 1999 at 1235.

[148] JX-28 at 13; Tr., May 5 at 1235-37. Respondent Dieterich testified that in response to McGough's requests, Compliance was aware of all "activity and the trading that the branch was responding to" and if there were any questions on active account review, "make sure the documentation was coming in." Id. at 1235. Compliance also reviewed the solicitation of securities and mark-ups to make sure "they were in line with all rules and regulations." Id. at 1235-36. In response to McGough's direction to stay on top of the KKS Group's activity, Respondent Dieterich testified that he instructed his staff to bring anything to his attention that was out of their normal trading practices, larger positions, and securities that were being solicited that they were not aware of. Id. at 1239-1240. He testified that he did not instruct his staff to review the KKS accounts with respect to suitability or commissions, other than markups. Id. at 1240-1241, 1244-1245.

Group.[149] Since he failed to do so, and failed to take appropriate remedial action as to trading in the FPG Account, Complainant charges that Respondent Dieterich violated Rules 2110 and 3010.

There is no question that Respondent Dieterich was well aware of the concerns raised by the NYSE with respect to trading by the KKS Group and assisted senior management in drafting Sutro's response to the Special Examination Report.[150] Respondent Dieterich also was aware of the FPG Trading Account which was brought to his attention through receipt of copies of Respondent Willis' memoranda to Respondent Kraus concerning his meetings with the KKS Group in 1993.[151] Respondent Dieterich testified that he discussed the active accounts of the KKS Group with Respondent Willis, including the FPG Trading Account,[152] and that the FPG Account also came up in conversations with Respondent Kraus as a result of the NYSE examination.[153] Respondent Dieterich understood that FPG was taking large positions in securities and he remembers seeing notes concerning attempts to diversify the account.[154]

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[149] Complaint at ¶26.

[150] Tr., May 5, 1999 at 1218-1221, 1224-1225, 1265. Respondent Dieterich testified that he had several conversations with the NYSE examiner after receipt of the Special Examination Report (JX-22) and that Compliance was part of the undertaking to review the KKS accounts. Tr. May 5, 1999 at 1244. See also Respondent Dieterich's Motion at 3-4. He also testified, however, that no new compliance procedures were put into effect as a result of the NYSE audit; rather, Compliance made a greater effort to watch the daily trading activity of the KKS Group. Tr., May 5, 1999 at 1224-1226. Respondent Dietreich testified that he discussed with his staff problems relating to mark-ups in excess of five percent and solicitation of securities. Id. at 1226.

[151] Id. at 1229-30.

[152] Id. at 1230-32.

[153] Id. at 1252. Respondent Dieterich testified that he was present at the meeting with the NYSE in December 1993 and took notes. He also was present when the NYSE examiner reviewed documents in Respondent Willis' office following the meeting with the KKS Group and believed that the NYSE was satisfied that Sutro was supervising the KKS accounts and "making appropriate determinations." Id. at 1265.

[154] Id. at 1234-1235.

In response to specific questions from the Panel as to what he did as Director of Compliance to review the KKS Group's accounts for suitability and commissions, Respondent Dieterich testified more fully and provided more detailed information concerning what Compliance did to review the KKS Group's active accounts.[155] He testified that Compliance looked at account forms, monthly statements, and active account reports. Further, he testified that he spoke with the KKS Group about its "sales pitch," how it conducted business, and its client base to determine if customers had assets outside the Firm and "if this is their play money."[156]

> I remember doing that on all of these accounts and making sure that this trading is suitable for these clients. These are active brokers. These are brokers that were not typical brokers at Sutro when I first started.[157]
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> * * *
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> We looked at these accounts for suitability aspects. I asked the broker questions and I asked Mr. Willis questions and I reported back to the firm, George and Jack and Mary Jane[158] as to what we were finding. Things seemed to be and appeared to be, in my opinion, suitable. * * *[159]
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> * * *
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> With respect to * * * [FPG], Bill and the KKS independently told me he had a 'system at home.' He was getting real time quotes that we were getting. He was up to date and sophisticated and I had no reason to doubt that, coming from two independent sources.[160]

In further response to the Panel's inquiry, Respondent Dieterich testified that he repeatedly asked Respondent Willis, Ms. Richardson, and the KKS Group questions about FPG, including how much money does he have and where are his assets?

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[155] Cf. Tr., May 5, 1999 at 1261-1262 with id. at 1224-1225 and 1240-1241; see also id. at 1267.

[156] Id. at 1262.

[157] Id.

[158] "George" is McGough, "Mary Jane" is Mary Jane Delaney, the General Counsel of Sutro during the relevant time period (Tr., May 5, 1999 at 1191-1192), and "Jack" is Jack Luikart, the President of the Firm (Tr., March 25, 1999 at 595).

[159] Tr., May 5, 1999 at 1264.

[160] Id. at 1264-1265.

According to Respondent Dieterich, he repeatedly got the same answers and he was led to believe from those conversations that FPG had much more than $1 million plus and was not "betting the ranch" on his trades.[161] Based on these conversations, he believed that FPG was "a sophisticated, wealthy individual that wanted to trade and * * * knows what he is involved in and knows what he is trading and is approving every single trade * * *."[162]

Because of the inconsistencies in his testimony, the Hearing Panel did not find Respondent Dieterich's testimony entirely credible. Moreover, if Respondent Dieterich reviewed the KKS accounts, he either ignored apparent "red flags" of irregularity or did not understand the concept of suitability. In fact, based on his testimony, which focused on the purported sophistication of FPG, the Panel concludes that he did not understand the concept of suitability. Nevertheless, the Panel finds that Complainant did not meet its burden to prove that that Respondent Dieterich had authority to supervise the KKS Group as charged in the Complaint.

The SEC has reasoned that "a supervisory person would be responsible only if the employee who violated [the securities] laws was subject to his supervisory jurisdiction" and that "the most probative factor that would indicate whether a person is responsible for the actions of another is whether the person has the power to control the other's conduct."[163] Further, the SEC noted that indicia of clear and direct authority to control the conduct of salespersons include the power to hire or fire, and to reward or punish.[164]

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[161] Id. at 1271-1272.

[162] Id. at 1273.

[163] In re Arthur James Huff ("Huff"), Exchange Act Rel. No. 29017, 50 S.E.C. 524, 1991 SEC LEXIS 551,*17, 19 (March 28, 1991)(concurring opinion)(citations omitted). Citing the decision in Huff, the SEC

Here, there is no evidence that Respondent Dieterich had any responsibility or authority to supervise or control the KKS Group.[165] Respondent Dieterich did not have authority to hire, fire, reverse a trade, or reduce the compensation of any of the AEs.[166] He did have responsibility to report to Sutro's management certain activities of the KKS Group and, based on his testimony, the Hearing Panel finds that he fulfilled those responsibilities.

The Hearing Panel also finds that Respondent Dieterich fulfilled the responsibilities given to him by McGough to "keep an eye on KKS."[167] According to his testimony, he reviewed the KKS Group's trading patterns and communicated with KKS Group members, Respondent Willis, and Ms. Richardson regarding the FPG Trading Account, including financial information concerning FPG.[168] The Hearing Panel finds that he relied on Respondent Willis to make personal contact with FPG to assess and

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has stated "[e]mployees of brokerage firms who have legal or compliance responsibilities do not become 'supervisors' * * * solely because they occupy those positions." Rather, "determining if a particular person is a 'supervisor' depends on whether, under the facts and circumstances of a particular case, that person has a requisite degree of responsibility, ability, or authority to affect the conduct of the employee whose behavior is at issue." In re John H. Gutfreund, 1992 SEC LEXIS 2939,*46-47 (March 25, 1992).

[164] Huff, 1991 SEC LEXIS 551 at *20, 21.

[165] See, e.g., id. As the SEC stated in Huff, "there are only a handful of cases in which the Commission has proceeded against a broker-dealer employee for failing to supervise a salesperson for which the employee did not have line responsibility * * *." Id. In Huff, the SEC distinguished the decision in In the Matter of Michael E. Tennenbaum, Exchange Act Rel. No. 18429, 57 S.E.C. 703, 1982 SEC LEXIS 2434 (Jan. 19, 1982), where a non-line employee, without authority to hire, fire, or reduce the pay of a salesperson, was found to be a supervisor over a broker-dealer employee, emphasizing "[o]f critical importance is the fact that Tennenbaum had sole authority to permit a salesman to handle discretionary options accounts." Id. at *23. The situation here also is distinguishable from In re First Albany Corp., Exchange Act Rel. No. 30515, 50 S.E.C. 890, 1992 SEC LEXIS 719, *16 (March 25, 1992). There, unlike here, the SEC specifically noted that the Chief Compliance Officer "had the power to take disciplinary action against a registered representative who violated firm policy by removing commissions and imposing small fines." Id. The SEC also found that the Chief Compliance Officer was well aware that the registered representative was engaged in violative activity and failed to take appropriate action. Id. at *16-18.

[166] McGough testified that Respondent Dieterich had no such authority. Tr., March 25, 1999 at 691-692.

[167] Tr., May 5, 1999 at 1235.

verify FPG's financial information and sophistication. Further, as presented to him by Respondent Willis and the KKS Group, Respondent Dieterich appears to have relied on information he believed came directly from FPG.[169] Based on that information, Respondent Dieterich formed opinions about FPG and trading in the Account which he passed along to senior management.

Based on the foregoing, the Hearing Panel finds that Complainant failed to meet its burden to prove that Respondent Dieterich had the authority or responsibility for supervising the KKS Group or that he failed to fulfill his responsibility for monitoring activities in the FPG Trading Account consistent with the directives given to him by McGough. Accordingly, the Hearing Panel finds that Complainant failed to prove that Respondent Dieterich violated NASD Conduct Rules 3010 and 2110 as alleged in the Fourth Cause of Complaint.

b. Adequate supervisory procedures

The Hearing Panel also finds that Complainant failed to prove that Respondent Dieterich failed to establish, maintain, or enforce adequate supervisory procedures with respect to monitoring the activities of the KKS Group and the FPG Account. In its undertakings to the NYSE, Sutro set forth a special system of supervision specifically directed at the KKS Group. This extra "system" was added on to an already existing supervisory system.[170]

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[168] Id. at 1261-1265. No evidence was presented that Respondent Dieterich was responsible for directly obtaining financial information from FPG or any other customer.

[169] See, e.g., Tr. May 5, 1999 at 1271-1272.

[170] See, e.g., id. at 1247.

The evidence demonstrates that Respondent Dieterich formed opinions and gave advice based on his role in the special supervisory system, but that the system was created by Sutro's management.[171] There is no evidence that Respondent Dieterich was separately or independently responsible for implementing a system of supervision other than the one developed and approved by Sutro's senior management in response to the expressed concerns of the NYSE. Further, Complainant failed to prove that Respondent Dieterich did not maintain or enforce such supervisory system. Thus, the Hearing Panel finds that Respondent Dieterich did not violate NASD Conduct Rules 3010 and 2110 as alleged in the Fifth Cause of Complaint.

4. Findings As To Respondent Kraus

Respondent Kraus was the Executive Vice President and Director of Retail for Sutro during the relevant time period. He was responsible for the 17 branch offices, recruitment, marketing, sales, the special products department, and any problems that might be brought to his attention with respect to branch office operations. He also was responsible for monitoring the profits and losses and business operations of the branch offices.[172] He was not responsible for compliance functions on a daily basis.[173]

As part of his responsibility for the branch offices, he spoke with the managers on a regular basis and also visited the branches.[174] He was the direct supervisor of the

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[171] Id. at 1242. As Respondent Dieterich testified – "I think the [compliance] department was helping the firm with its directives that George McGough had put together with KKS. * * * We were working with George and senior management."

[172] Id. at 1287.

[173] Id.

[174] Id. at 1289.

branch managers, including Respondent Willis.[175] Specifically, with respect to his supervision of Respondent Willis, he spoke with him on a regular basis concerning the business of the Los Angeles branch and had regular branch office visits with him and his personnel.[176]

a. Supervision of Respondent Willis

Respondent Kraus testified that Respondent Willis had responsibility to ensure that the recommendations made by his brokers were suitable and that he supervised Respondent Willis in this respect by making sure that he was performing his duties as branch manager. He did not, however, specifically ask Respondent Willis about the suitability of the brokers' recommendations.[177]

Respondent Kraus became aware of the Special Examination Report (JX-22) of the NYSE when it was received by Sutro in 1993 [178] and he was aware that the NYSE was concerned about whether supervision of the KKS Group was adequate, its trading activity, and the commissions generated by its clients.[179] He was not involved, however, in drafting the response to the NYSE, nor did he see McGough's August 1993 letter to the NYSE setting forth Sutro's undertakings.[180]

In response to the NYSE's concerns, Respondent Kraus was involved in discussions with other members of the executive committee. The discussions focused on

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[175] Id. at 1289-90.

[176] Id. at 1293-94.

[177] Id. at 1304-1305.

[178] Tr., May 5, 1999 at 1299-1300.

[179] Id. at 1302.

[180] Id. at 1303. Respondent Kraus testified that McGough made decisions as to who should do what in response to the NYSE findings and "took over" how to respond with assistance from Respondent Dieterich and Mary Jane Delaney. Id. at 1304.

diversification of the KKS Group's business. The committee agreed that Respondent Willis should meet regularly with the KKS Group to review its accounts and client base and to encourage diversification of its business.[181] Respondent Kraus testified that diversification of the KKS Group's business was a huge focus and that he specifically told the members that they had to diversify.[182]

McGough testified that he expected Respondent Kraus to speak with Respondent Willis about the KKS Group's activity and diversification of its clients and product mix.[183] Similarly, Respondent Kraus testified that he was told by McGough to make sure that he was talking with Respondent Willis, that Respondent Willis understood that McGough wanted these meetings with the KKS Group, that he wanted the meetings documented, and that Respondent Willis should report to Respondent Kraus on a regular basis as to those meetings.[184]

In October 1993, McGough sent Respondent Kraus a note asking him whether he perceived any improvement in the product mix of the KKS Group.[185] Although Respondent Kraus did not respond in writing, he testified that he told McGough that the only improvement was from accounts assigned to them from other brokers.[186]

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[181] Id. at 1305-1306, 1309-1310.

[182] Tr., May 6, 1999 at 1564, 1565.

[183] Tr., March 25, 1999 at 670.

[184] Tr., May 5, 1999 at 1307-08.

[185] JX-28 at 17; Tr. May 5, 1999 at 1317.

[186] Id. at 1318.

Respondent Kraus continued to work with Respondent Willis on a regular basis and met with the KKS Group to discuss diversification of its business.[187]

b. The FPG Account

Respondent Kraus was aware of FPG and knew that his Trading Account was one of the most active in the Los Angeles Branch office.[188] He also knew that the account was quite profitable at one point.[189] Based on his discussions with Respondent Willis, he understood that FPG was very sophisticated, that he had a net worth of $3 million,[190] and that "he loved the market."[191] Respondent Willis did not discuss any problems concerning the FPG Account nor did he discuss specifically the level of trading in the Account.[192] Respondent Kraus knew that FPG had signed a customer awareness

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[187] Id. at 1318-19. Respondent Kraus noted that the KKS Group was very resistant to change and had no interest in selling bonds or selling mutual funds. Rather, they told Respondent Kraus they wanted to do a stock business and that is why they came to the Firm. In an effort to encourage them to change their business, Sutro agreed to give the KKS Group a substantial draw for a period of time so that they could rebuild their business. Id. at 1320. The Group was not successful in doing so and that is why R. Kernweis and Sklar left Sutro. G. Kernweis was somewhat successful in this effort and stayed for a period of time. Id. at 1321.

[188] Tr., May 6, 1999 at 1500-01.

[189] Id. at 1508.

[190] Respondent Kraus testified that Respondent Willis told him that FPG was worth $3 million and his inference was that because Respondent Willis had spoken to the client, he knew it was $3 million. Tr., May 6, 1999 at 1555-1556.

[191] Id. at 1518. Respondent Kraus did not discuss with Respondent Willis the positions FPG was taking or how much equity was in his account. Respondent Kraus primarily was interested in the sophistication of the customer. Id. at 1519.

[192] Id. at 1504-1505. Respondent Kraus testified that Respondent Willis did not discuss with him specific trading activity in any of the KKS Group's customer accounts. Id. at 1511, 1556. He knew that the KKS Group sometimes took large positions in certain securities and he would ask Respondent Willis about those positions, including whether he was talking with the KKS Group regularly, whether he was speaking with customers, and whether he was reviewing accounts and sending active account letters. Id. at 1511-1512. Respondent Kraus did not review the active account reports. Rather, he testified that he relied on Respondent Willis, Ms. Richardson, and the Compliance Department to do their respective jobs. Id. at 1534, 1536-1537.

letter.[193] This confirmed to Respondent Kraus that FPG knew exactly what he was doing.[194]

At some point in 1994, as a result of an internal audit,[195] Respondent Kraus became aware that the FPG Account was one of the largest in terms of commissions to the Firm.[196] As a result of that report, the KKS Group was stopped from making any "buy" recommendations to FPG.[197]

c. Findings pursuant to NASD Conduct Rule 3010

The foregoing evidence demonstrates that Respondent Kraus spoke with Respondent Willis on a regular basis, that he was aware of the activity of the KKS Group, and that he generally was aware of the activity in the FPG Trading Account. The evidence also demonstrates that Respondent Kraus knew of the concerns of the NYSE and knew that the Firm, through the Compliance Department and Respondent Willis, heightened its supervision of the KKS Group in response thereto. He received memoranda from Respondent Willis as to his meetings with the KKS Group and also was directed by McGough to make sure that Respondent Willis was staying on top of the activities of the KKS Group.

Based on the foregoing, Complainant charges that Respondent Kraus "may be the most culpable supervisory respondent" and that he had enough "'red flags' to have alerted

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[193] Id. at 1505.

[194] Id. at 1520, 1555. Respondent Kraus did not independently investigate FPG's income or net worth. Rather he relied on Respondent Willis and the Compliance Department to review the new account forms as well as any other information from FPG to determine suitability. Id. at 1521.

[195] JX -17.

[196] Tr., May 6, 1999 at 1512. Respondent Kraus testified that, prior to the audit, he was not aware of the commissions generated in the FPG Trading Account and the P&L statements for the Los Angeles Branch did not identify specific accounts. Id. at 1513.

him to the need for further action."[198] Complainant argues that because the KKS Group was not being effectively supervised by Respondent Willis, Respondent Kraus had the duty to follow up and investigate. Since Respondent Kraus failed to take appropriate action to supervise the KKS Group, Complainant contends that he violated NASD Conduct Rules 2110 and 3010.[199]

The Hearing Panel disagrees. Respondent Kraus' testimony at the Hearing, which emphasized the purported sophistication of FPG, and diversification of the KKS Group's customer accounts, reflects that Respondent Kraus either did not focus on suitability or that he does not understand the concept of suitability. The Hearing Panel finds, however, that Respondent Kraus did not have any direct responsibility for supervising the activities of the KKS Group. The Hearing Panel also finds that Respondent Kraus did not have any responsibility for reviewing activity in the KKS Group's individual customer accounts. Other than ensuring that Respondent Willis met with the KKS Group to discuss its customer accounts and diversification, McGough did not assign Respondent Kraus any responsibility with respect to the Firm's undertakings to the NYSE.

Further, Complainant did not establish that Respondent Kraus had actual knowledge of the trading in the FPG Account or that he received any reports that would have disclosed such trading activity. There is no evidence that Respondent Kraus received any reports regarding individual customer accounts. In fact, except with respect

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[197] Id. at 1527.

[198] Complainant's Opp. at 13. Complainant further charges that Respondent "Kraus chose not to review any source documents which would have alerted him to the violative conduct."

[199] Complaint at ¶27.

to his own customers, he did not receive any reports that disclosed trading activity in a particular account.[200]

The evidence establishes that Respondent Kraus fulfilled his responsibilities with respect to the supervision of Respondent Willis. He spoke with Respondent Willis and others at the Los Angeles branch on a regular basis, asked appropriate questions, and received answers which he justifiably believed were based on conversations with FPG. He also received and reviewed memoranda from Respondent Willis respecting his meetings with the KKS Group and met personally both with Respondent Willis and the KKS Group to discuss diversification of its business. Respondent Kraus fulfilled the specific supervisory responsibilities of Respondent Willis assigned to him by McGough. Complainant provided no evidence that Respondent Kraus was aware of any "red flags" which should have caused him to undertake an independent investigation.[201]

Under the circumstances of this case, the Hearing Panel cannot conclude that Respondent Kraus' overall discharge of his responsibility as Respondent Willis' supervisor fell below a standard of reasonableness so as to amount to a failure to supervise. Accordingly, the Hearing Panel finds that Complainant failed to prove that Respondent Kraus violated Conduct Rule 3010.

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[200] Tr., May 6, 1999 at 1502-1503.

[201] Cf. In the Matter of the Application of Bradford John Titus, Exchange Act Rel. No. 38029, 52 S.E.C. 1154, 1996 SEC LEXIS 3341 (Dec. 9, 1996). See Complainant's Opp. at 14. In Titus, unlike here, the individual respondents had direct supervisory responsibilities with respect to the registered representative's trading activities and, also, reviewed daily trade blotters which reflected that, despite their instructions, the registered representative had not decreased his trading activity.

III. SANCTIONS AS TO RESPONDENT WILLIS

The applicable Sanction Guideline for failure to supervise in violation of NASD Conduct Rules 2110 and 3010 suggests a fine of $5,000 to $50,000 and a suspension of the responsible individual in all supervisory capacities for up to 30 business days.[202] In egregious cases, the applicable Guideline suggests suspending the responsible individual in any or all capacities for up to two years or a bar.[203]

In addition to the principal considerations that adjudicators always should consider in imposing sanctions,[204] the applicable Guideline recommends that adjudicators consider "whether respondent ignored 'red flag' warnings that should have resulted in additional supervisory scrutiny."[205] In this regard, adjudicators should consider whether the individuals responsible for the underlying misconduct attempted to conceal the misconduct from respondent. In addition, adjudicators are to consider the nature, extent, size, and character of the underlying misconduct, and the quality and degree of the supervisor's implementation of the firm's supervisory procedures and controls.[206]

The Panel finds that Respondent Willis honestly believed that FPG was a very sophisticated investor, who wanted to speculate, and had the financial means to do so.

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[202] Sanction Guidelines ("Guidelines") at 89.

[203] Id.

[204] Id. at 8-9.

[205] Id. at 89.

[206] Id.

The Hearing Panel also finds that, based on what R. Kernweis told him, Respondent Willis believed FPG was worth $3 million.[207]

Further, the Hearing Panel also finds that the management of Sutro was aware of, and generally approved of, Respondent Willis' management of the KKS Group. Respondent Willis kept Sutro's management, including McGough and Respondent Kraus, informed of the activities of the KKS Group and his attempts to get it to diversify its business. In this respect, Respondent Willis generally followed the procedures McGough established for supervising the KKS Group in response to the NYSE examination. In fact, according to the documentary evidence, in December 1993, the NYSE examiner noted "I am comfortable with Bill's supervision of these brokers"; "Bill is a very good manager"; and "Bill knows so much about the a/cs."[208]

Notwithstanding the foregoing, there is no doubt that Respondent Willis ignored certain "red flags." The new account form filed when FPG first began trading with Sutro in January 1993, and the subsequent account forms for FPG's IRAs, filed in June and November 1993, all reflect that FPG was retired and had a net worth of $1 million. In addition, as early as June 1993, FPG informed Respondent Kernweis that he would not be putting more money into his Trading Account because of liquidity concerns. Moreover, Respondent Willis was aware, or should have been aware from his review of order tickets and account statements, that FPG was selling securities at a loss from his IRA accounts in

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[207] Tr., June 8, 1999 at 1634.

[208] JX-43 at 22, 27; Tr., June 8, 1999 at 1667-1668.

order to cover margin calls in his Trading Account. Yet, Respondent Willis never asked FPG about his financial situation or his net worth.

Although the violations at issue here took place in only one customer account, the nature, extent, size, and character of the underlying misconduct was egregious. The total losses in the Trading Account over an eighteen month period were $316,000.00.[209] Respondent Willis knew that FPG was relying heavily on the use of margin, regularly taking $1 million positions in speculative securities,[210] and, at times, investing more than 100% of his liquid net worth.

Respondent Willis also knew that FPG traded from one speculative security to another on the average of every two weeks and that the Trading Account was required to generate an unrealizable 150% return in order to cover the costs of trading. Moreover, Respondent Willis knew that over the eighteen month period, the commissions and sales credits in the Trading Account alone were over $880,000[211] and represented a high percentage of FPG's net worth.[212]

Further, the documentary evidence demonstrates that Respondent Willis spoke with FPG only twice during the relevant time period, the first time eight months after the high risk trading had commenced. This was in clear contravention of the Firm's preferred

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[209] For an eighteen month period, the total losses in all three FPG accounts were in excess of $670,000.00.

[210] Tr., June 8, 1999 at 1634.

[211] When the commissions and other sales charges generated by FPG's IRA accounts are added, the total costs to FPG during the relevant eighteen month period were over $1 million.

[212] Tr., June 8, 1999 at 1636.

policy. Moreover, given the nature of the trading activity, the quality of Respondent Willis' contact was not sufficient. Respondent Willis never discussed FPG's financial situation, net worth, or reducing commissions.

In addition to the foregoing specific factors relevant to determining sanctions for failure to supervise, the Hearing Panel also considered the applicable principal considerations set forth in the Guidelines as well as other factors uniquely relevant to the circumstances of this case.

Although the National Adjudicatory Council ("the NAC") recently made clear that the absence of disciplinary history is not a mitigating factor,[213] the Panel thought it appropriate to consider Respondent Willis' long, unblemished career in the securities industry. With the exception of this proceeding, in over 20 years in the industry, Respondent Willis has no disciplinary history.[214] Respondent Willis spent most of this time in managerial positions, first at Prudential Securities, then at Sutro and, before this case was filed, at Merrill Lynch. Over his career, Respondent Willis has supervised hundreds of registered persons and customer accounts without any disciplinary action against him. Moreover, the events at issue here occurred over six years ago. Thus, the Panel concludes that while Respondent Willis exercised poor judgment under the specific circumstances of this case, the violations herein truly are an aberration.

Further, the Panel considered that Respondent Willis' supervision of the KKS Group was known both to Sutro management and the NYSE. In fact, both the NYSE and

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[213] In re Balbirer, Complaint No. C07980011 at 5 (NAC Oct. 18, 1999).

[214] Respondent Willis' Br. at 11; see also Complainant's Br. at 9.

McGough were aware of the problems with the KKS Group and seemed to approve of Respondent Willis' supervision thereof.[215] This is not a situation where Respondent Willis attempted to hide the alleged misconduct or to conceal what he was doing from his superiors. In fact, at one point, Respondent Willis suggested terminating the KKS Group, an idea which was rejected by McGough.[216]

Respondent Willis allowed himself to be misled or deceived by R. Kernweis and ignored "red flags" of irregularity. There is no evidence, however, that Respondent Willis, in turn, attempted to deceive anyone about his actions. While the Panel finds that Respondent Willis was negligent in his supervision of the KKS Group with respect to the FPG Account, there is no evidence that Respondent Willis intended to harm FPG or to commit any intentional wrongdoing.

In addition to the foregoing, the Panel was impressed by Respondent Willis' candor and credibility during the Hearing. The Panel recognizes that a branch manager is in an extremely difficult position. A branch manager must supervise brokers without becoming an obstacle between them and their customers. The branch manager must ensure that brokers comply with applicable rules and regulations and, also, keep superiors informed. The branch manager must follow a firm's direction and, yet, when it comes to supervision, must exercise independent judgment. Here, Respondent Willis did not seek to avoid responsibility for his supervision of the KKS Group or the FPG Trading Account. Rather, he mistakenly believed that he was acting appropriately by allowing FPG to invest as he wished.

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[215] See, e.g., Tr., March 25, 1999 at 679; Tr., June 8, 1999 at 1584-89, 1612, 1627.

[216] Tr., May 6, 1999 at 1556-1557.

In determining sanctions, the Panel also considered that Respondent Willis already has been penalized severely as a result of these proceedings, having been suspended as a supervisor and forced into a career change. Prior to the initiation of this proceeding, Respondent Willis was employed by Merrill Lynch as a Resident Vice-President, managing Merrill Lynch's Pacific Gateway Complex.[217] In 1997, Respondent Willis received the firm's highest rating in terms of overall performance and received offers to take more significant positions.[218] Because, however, of the likelihood of these proceedings, Respondent Willis declined to interview for such positions.

When the Complaint was filed, Merrill Lynch first placed Respondent Willis on temporary administrative leave and then, because the proceedings dragged on, replaced Respondent Willis permanently as manager of the Complex.[219] Merrill Lynch effectively suspended Respondent Willis from any supervisory responsibilities and, instead, assigned him to conduct training programs for new brokers and clerical personnel.[220]

Respondent Willis finally has secured a new position with Associated Securities as its Chief Marketing Officer, a position that primarily involves recruiting new financial planners. He has no supervisory responsibilities over the financial planners.[221] The Panel

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[217] Tr., June 8, 1999 at 1575, 1669-70. In that position, he supervised four offices, a management team of six individuals, approximately 85 financial consultants, and a total of 125 employees. Respondent Willis' Br. at 7.

[218] Tr., June 8 at 1669-70.

[219] Tr., June 8, 1999 at 1669-70; Respondent Willis' Br. at 7-8.

[220] Id. at 1575, 1669-70; Respondent Willis' Br. at 7-8.

[221] Respondent Willis' Br. at 10.

recognizes that based on the single incident in this proceeding, it is unlikely that Respondent Willis ever will be employed by a national securities firm in a managerial position.

In determining sanctions, the Panel examined other analogous cases involving supervisory failures and similar charges. Although distinguishable on their facts, certain cases provide an appropriate benchmark or guidance for a supervisory case such as this which does not involve fraud or intentional wrongdoing by respondent.[222]

The decision in Philadelphia Investors is especially instructive. There, the SEC Administrative Law Judge ("the ALJ") found that respondent reasonably failed to supervise a registered representative who, among other things, operated a Ponzi scheme. The ALJ found that the supervisor was aware of "red flags" indicating the registered representative's improprieties and, having discovered these "red flags," should have taken further action.[223]

The ALJ, however, rejected the staff's recommendations for harsh sanctions which included a bar in any supervisory capacity. As relevant here, the ALJ noted that the "egregiousness of Respondents' failure to supervise * * * is tempered by several mitigating factors" --

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[222] See, e.g., Hume, 1995 SEC LEXIS 983, Benz, 1997 SEC LEXIS 672; District Business Conduct Committee No. 2 v. Glicksman, Complaint No. C02960039, 1999 NASD Discip. LEXIS 12 (March 31, 1999), aff'd, In re Harry Glicksman, Exchange Act Rel. No. 42255, 1999 SEC LEXIS 2685 (December 20, 1999)[Glicksman, the registered representative, conducted 106 transactions in a client's accounts, turned the portfolio over 21 times in a 14-month period, and charged fees and commissions equal to 21% of the accounts' initial principal. The NASD censured Glicksman's supervisor, imposed a fine of $5,000, and required him to requalify as a GSP.]; Scudder Investments, 1999 SEC LEXIS 2737 [The SEC suspended and fined a supervisor for allowing a broker to make unauthorized derivative trades resulting in more than $16 million in investor losses]. In none of these cases was a fine greater than $10,000 or a bar imposed on the supervisor.

[223] 1998 SEC LEXIS 466, at *45.

> I believe that Mr. Wurts' worst fault in this case was his misplaced trust in Mr. Cohen. He exhibited serious lapses of judgment and reason, and an uncharacteristic lack of care in his supervision over Mr. Cohen. * * * But, it was Mr. Cohen, not Mr. Wurts, who committed the egregious acts which are the underlying bases for this proceeding. Mr. Wurts may have discovered illegalities had he fulfilled his supervisory duties, but he did not knowingly allow Mr. Cohen to operate his illegal scheme. There is no indication that Mr. Wurtz acted intentionally to further Mr. Cohen's scheme.[224]

In imposing sanctions of a censure and a civil penalty of $5,000, the ALJ noted that respondent was an exemplary supervisor, with over 30 years of experience in the industry, and no prior disciplinary history. He also noted that the likelihood of future violations was slim.[225] The ALJ recognized that a supervisory bar probably would result in an end to respondent's career in the securities industry and that respondent was not such a threat to the public interest to merit such a severe sanction.[226]

Complainant recommends that Respondent Willis be barred from associating with any member firm in all principal capacities and fined $30,000.00. The Hearing Panel rejects such proposal. The stated intention of the Guidelines is not to be punitive, but to "remediate misconduct and to protect the investing public."[227] As in Philadelphia Investors, the Panel finds that Respondent Willis' conduct is tempered by mitigating factors. Moreover, the Panel does not believe that Respondent Willis poses such a threat to the public interest or to the integrity of the securities industry to justify a bar which, effectively, would end his career.

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[224] Id. at *50.

[225] Id. at *51.

[226] Id. at *51-52.

[227] Sanction Guidelines at 3, ¶1.

Accordingly, based on the relevant factors discussed herein, the Panel believes that the following sanctions are appropriate: a fine of $10,000; requalification by examination as a principal (Series 24) within ninety (90) days of the date this decision becomes the final disciplinary action of the Association; and a suspension of thirty (30) days from associating with any member firm in a supervisory capacity, such suspension to run concurrently with requalification. These sanctions are within the range set forth in the Guidelines for supervisory violations and are consistent with other recent cases cited herein involving similar charges.[228]

CONCLUSION

The Panel finds that Complainant failed to meet its burden to prove that Respondents Dieterich violated NASD Conduct Rules 2110 and 3010 as alleged in the Fourth and Fifth Causes of Complaint.

The Panel finds that Complainant failed to meet its burden to prove that Respondent Kraus violated NASD Conduct Rule 3010 as alleged in the Fourth Cause of Complaint.

The Panel finds that Respondent Willis violated NASD Conduct Rule 3010 as alleged in the Fourth Cause of Complaint by failing reasonably to supervise the KKS Group with respect to the FPG Account and that the following sanctions are appropriate: a fine of $10,000; requalification by examination as a principal (Series 24) within ninety (90) days of the date this decision becomes the final disciplinary action of the

[228] They also are consistent with the other sanctions imposed in this proceeding. In fact, Respondent Sutro, as well as Respondents Sklar and G. Kernweis, reaped the greatest benefit from the unsuitable trading strategy and received relatively light sanctions. McGough, who clearly was aware of all of the activities of the KKS Group, the findings of the NYSE, and, as was evident to the Panel, had a very "hands-on" management style, was not charged at all.

Association; and a suspension of thirty (30) days from associating with any member firm in a supervisory capacity, such suspension to run concurrently with requalification.

Costs of the Hearing in the amount of $1,498.25 are assessed against Respondent Willis.

These sanctions shall become effective on a date determined by the Association, but no sooner than thirty (30) days from the date this decision becomes the final disciplinary action of the Association.[229]

THE HEARING PANEL

By______________________
Ellen A. Efros
Hearing Officer

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[229] The Hearing Panel has considered all arguments of the Parties. They are rejected or sustained to the extent they are inconsistent or in accord with the findings herein.