

**NASD REGULATION, INC.  
OFFICE OF HEARING OFFICERS**

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DEPARTMENT OF ENFORCEMENT,	:	
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	:	
Complainant,	:	Disciplinary Proceeding
	:	No. C02980070
v.	:	
	:	
FREDERICK D. SMITH	:	<b>HEARING PANEL</b>
(CRD #2167780),	:	<b>DECISION</b>
	:	
Los Angeles, CA	:	Hearing Officer - DMF
	:	
	:	April 28, 1999
Respondent.	:	

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*Digest*

The Department of Enforcement filed a Complaint alleging that Frederick D. Smith (1) violated NASD Rules 2110 and 2330(a) by converting to his own use funds he received from two investors, and (2) violated Rule 2110 by making a false statement in a Form U-4. Smith submitted a response to the Complaint in which he denied the violations charged, and requested a hearing. Enforcement, however, filed a motion for summary disposition of the charges, pursuant to Rule 9264, which Smith opposed.

The Hearing Panel granted Enforcement's motion. The Hearing Panel determined that there was no genuine issue with regard to any material fact, and that Enforcement was entitled to summary disposition in its favor on the conversion charge. The Hearing Panel also held, however, that Smith was entitled to summary disposition in his favor on the U-4 charge. As sanctions for the conversion charge, the Hearing Panel censured

Smith, barred him from associating with any member firm in any capacity, fined him \$151,431.35, and ordered him to pay restitution in the amount of \$10,000, plus interest to one injured investor, and \$4,286.27, plus interest, to estate of the other. The Hearing Panel dismissed the charge that Smith made a false statement on a Form U-4.

### *Appearances*

Joy H. Hansler, Senior Regional Attorney, Los Angeles, CA (Rory C. Flynn, Washington, DC, Of Counsel), for the Department of Enforcement.

Frederick D. Smith, pro se.

## **DECISION**

### **1. Introduction**

The Department of Enforcement filed its Complaint against respondent Frederick D. Smith on October 26, 1998.<sup>1</sup> The Complaint charged that Smith violated NASD Rules 2110 and 2330(a) by converting to his own use funds that he obtained from EV and LM for investment. The Complaint also charged that Smith violated Rule 2110 by falsely stating on a Form U-4 that he had never been charged with any misdemeanor involving fraud, false statements, or omissions. Smith filed a response to the Complaint in which he denied converting the customers' funds, and stated that he answered the Form U-4 based on advice from a compliance officer.

Smith requested a hearing, but Enforcement filed a motion for summary disposition, pursuant to Rule 9264, together with supporting exhibits (CX 1-26), including numerous excerpts from Smith's testimony given to the NASD during the

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<sup>1</sup> The NASD investigation that led to the Complaint was based on a referral from the SEC. (CX 4.)

investigation leading to the Complaint, excerpts from the investigative testimony of EV, the declaration of an NASD investigator, and various supporting documents. Smith filed a response to Enforcement's motion, but did not submit any exhibits. Upon review of the Complaint, Smith's Answer, Enforcement's motion and supporting exhibits, and Smith's response to the motion, the Hearing Panel has determined that there is no genuine issue regarding any material fact, and that Enforcement is entitled to summary disposition on the conversion charge. The Hearing Panel has also determined, however, that Smith is entitled to summary disposition dismissing the charge that he made a false statement on a Form U-4.

## **2. Jurisdiction**

Smith was registered with NASD member firm Global Strategies Group, Inc., from October 26, 1995 until January 16, 1996. From November 21, 1996 until December 5, 1996, he was associated with member firm The Boston Group, but the NASD never approved his registration prior to the termination of his association with that firm. (CX 1 (CRD).) Because the Complaint charges misconduct while Smith was registered with Global Strategies Group and the Complaint was filed within two years after the termination of Smith's last association with a member firm, the NASD has jurisdiction over this proceeding, pursuant to Article V, Section 4 of the NASD's By-Laws.

## **3. Summary Disposition**

Rule 9264 provides a means by which any party may seek a summary disposition of any or all of the charges in a Disciplinary Complaint. Rule 9264(d) provides that the

Hearing Panel “may grant the motion for summary disposition if there is no genuine issue with regard to any material fact and the Party that files the motion is entitled to summary disposition as a matter of law.”

In this case, the Hearing Panel has found that the exhibits offered by Enforcement, which consist largely of excerpts from Smith’s own testimony, as well as documents and statements of other witnesses that Smith confirmed in his testimony, establish that there is no genuine issue regarding any material fact, and that this proceeding is appropriate for resolution by summary disposition, without any need for an evidentiary hearing.

#### **4. The Conversion Charge**

##### **A. Facts**

Smith was President and sole owner of Global Asset Partners, Inc. (“Global”), which was incorporated in Nevada on or about December 13, 1995. Nevada canceled Global’s corporate charter on or about February 21, 1996. (CX 3, 4, 6.) Smith claims to have formed Global in order to provide capital financing and consulting services to “emerging growth companies” (CX 5), but it is clear from the record that, aside from collecting money from a few gullible investors, Global never had any real existence and never did any business. On December 19, 1995, Smith opened a securities account in Global’s name at Charles Schwab & Co., listing himself as sole owner of Global and the only person authorized to withdraw funds from the account. (CX 6.)

Kevin Wall, who had worked with Smith at various NASD member firms (CX 1-2), solicited the investment funds that are the subject of the conversion charge on behalf of Global. In late 1995, EV, who was 74 years old, received an unsolicited call from

Wall, during which Wall suggested that EV invest in Global. Wall subsequently sent EV promotional materials stating that Global had a 37.5% “year-to-date return 1/1/95-9/31/95”; a 20.69% “three year average annualized return”; and a 19.45% “five year average annualized return.” The materials also stated that Global “offers the prudent investor access to higher returns, ... identifies emerging growth situations, ... [and] is supported with quick access to accurate investment information & analytical tools,” and invited the reader to “join our family of investors.” (CX 16.) All of this was pure fiction. Global had no earnings history, no active business, no assets, and no “family of investors.”

EV gave Wall a check in the amount of \$10,000, dated December 28, 1995, for investment in Global. Wall, in turn, gave the check to Smith, who endorsed it and deposited the funds in Global’s Schwab account on December 29, 1995. EV has not received any communication from Smith or Global regarding his investment, or any dividend, interest payment, or the return of any portion of the \$10,000. (CX 4, 7, 10, 11, 14, 15, 17.)

On December 8, 1995, LM gave Wall a check for \$4,286.27, which LM obtained by liquidating his investment in a Franklin Templeton Fund. The check was payable to Global, and Smith endorsed and deposited the check in Global’s Schwab account. At the time of this investment, LM was 73 years old, very ill, and close to death. LM died of cancer in June 1996, and his surviving wife and adult daughter know little about the investment. Like EV, neither they nor LM’s estate has received any communication or payment from Smith or Global. (CX 4, 7, 11, 12, 14.)

The checks from LM and EV were the only funds deposited in the Schwab account prior to February 20, 1996.<sup>2</sup> Global invested the funds in a Schwab money market fund. Between December 20, 1995, and February 13, 1996, Smith obtained ten checks from Schwab, through which he withdrew \$14,298 from the Schwab account, representing all of the principal of LM's and EV's investments, as well as most of the money market fund earnings during that period. Smith was the payee on nine of the checks, while Wall was the payee on one \$5,000 check. (CX 8-10.)

During the investigation, Smith testified he gave Wall approximately half the funds that EV and LM invested – the \$5,000 check and another \$2,000 in cash that Smith obtained by cashing one of the other checks. Smith claimed that Wall “was to use that money to secure office space [for Global], and also to pay for expenses in researching our business plan, and a finder's fee,” but he admitted that Wall did not obtain office space or pay Global's expenses. Smith thought Wall used the money to pay personal expenses and buy drugs, but Smith made no effort to recover the funds from Wall. (CX 11.)

Smith said he cashed the remaining Schwab checks and used the money to pay expenses associated with Global, and he claimed he had receipts to document those payments, but he failed to produce any such receipts in response to several requests from the NASD, pursuant to Rule 8210. (CX 13, 18-20.) Smith also claimed he used some of

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<sup>2</sup> Another \$16,000 was deposited to the Schwab account on February 20, 1996, apparently representing funds obtained from a third investor. Enforcement did not charge Smith with converting those funds because by then he was no longer registered, and therefore his actions were no longer subject to NASD jurisdiction. (Complainant's Memorandum in Support of Motion for Summary Disposition, p. 1, n. 1.).

the funds to pay business expenses that he charged on a Visa card, and he provided copies of account statements for the card. Those statements, however, showed charges for personal expenses, such as restaurants, music stores, gasoline, and liquor. (CX 18-22.)

Smith acknowledged that he never repaid EV and LM any portion of their investment in Global. In fact, although Smith claimed that he viewed EV and LM as “shareholders” in Global, he testified that he had never spoken to either one, and had not made any record of their addresses or telephone numbers. (CX 26.)

### **B. Discussion**

An associated person “converts” funds in violation of Rule 2110 when the associated person “intends permanently to deprive the customer of the use of his or her funds (i.e., the associated person intends to ‘steal’ the funds).”<sup>3</sup> The undisputed facts in this case establish that Smith converted EV’s and LM’s funds under this standard.

It is undisputed that Smith took checks he knew Wall had solicited from customers for investment in Global, deposited the checks in the Schwab account he had opened in Global’s name, and either spent the money himself or gave it to Wall. While Smith claims Wall was supposed to use the money he received to rent office space for Global, Smith also admits that Wall used the money for his own purposes, and that he made no effort to recover the money. Smith says he spent the rest of the money on Global’s business expenses, but it is undisputed that the NASD has repeatedly requested that he provide documentation to support that claim, pursuant to Rule 8210, and Smith

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<sup>3</sup> District Business Conduct Committee for District No. 5 v. James C. Arnold, Complaint No. C05960034, at n.8 (emphasis in original) (NBCC February 25, 1997) (citing Joseph H. O’Brien, II, 51 S.E.C. 1112 (1994)); Raymond M. Ramos, 49 S.E.C. 868 (1988)).

has been unable to do so. In addition, the only documents Smith has provided – the Visa card account statements – do not show that Smith spent the money to develop Global’s business, but rather that he spent it on personal expenses. These facts, together with Smith’s admission that he has made no effort to contact the investors, and did not even make a record of their addresses or telephone numbers, compel the conclusion that he intended to “permanently deprive [EV and LM] of the use of [their] funds (i.e. [Smith] intend[ed] to ‘steal’ the funds).”

Thus, the undisputed facts establish that Smith converted to his own use funds obtained from EV and LM for investment in Global, in violation of Rule 2110, as charged in the Complaint.<sup>4</sup>

## **5. The Form U-4 Charge**

### **A. Facts**

In October 1990, when he was a minor, Smith was charged with the misdemeanor of being “a person under the age of twenty-one years who did willfully and unlawfully have in his possession a false and fraudulent written, printed, and photostatic evidence of age and identity” – that is, he was caught with a “fake ID.” The charge was subsequently dismissed. Smith disclosed the fake ID charge in the Form U-4 he submitted in September 1995 to register with Global Strategies Group, and the information was

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<sup>4</sup> The Hearing Panel rests its decision on this charge on Rule 2110, because Rule 2330(a), also cited in the Complaint, specifically addresses “improper use of a customer’s securities or funds.” EV and LM sought to invest in Global, but they were not brokerage customers of Smith or the firm with which he was then associated, so it appears Rule 2330(a) does not apply. Rule 2110, however, applies to conversion and other “business-related conduct that is inconsistent with just and equitable principles of trade, even if that activity does not involve a security.” Ernest A. Cipriani, Jr., Exchange Act Release No. 33675, 56 S.E.C. Docket 322 (SEC Feb. 24, 1994).



entered in his CRD record. In 1996, however, when Smith completed a Form U-4 to register with The Boston Group, he did not disclose the fake ID charge. Smith says he did not disclose the charge because the firm's compliance officer told him he was not required to do so, and Enforcement has not disputed this statement. (CX 1, 23-25; Answer to Complaint; Response to Motion for Summary Disposition.)

### **B. Discussion**

Form U-4 asks whether the Applicant has ever been charged with a felony or misdemeanor "involving: investments or an investment-related business, or any fraud, false statements or omissions, wrongful taking of property, or bribery, perjury, forgery, counterfeiting, extortion, or a conspiracy to commit any of these offenses." Enforcement argues that the terms "fraud, false statements or omissions" as used in Form U-4 are broad enough to cover the fake ID charge. The Hearing Panel concludes, however, that the applicability of those terms to a fake ID charge is not so clear that it was unreasonable for Smith to rely on the compliance officer's advice that he was not required to disclose the charge. Furthermore, the undisputed facts that Smith disclosed the charge on his previous Form U-4, and that, therefore, it was already reflected in his CRD record, lead the Hearing Panel to conclude that Smith did not intend to conceal the charge from The Boston Group, any other potential employer, or the NASD. Under all these circumstances, the Hearing Panel finds that the Form U-4 charge should be dismissed.

## **6. Sanctions**

The Sanctions Guideline for conversion recommends a fine of \$10,000 to \$100,000, plus five times the amount converted, and a bar.<sup>5</sup> Even though Smith has no prior disciplinary history, Enforcement argues that this is an egregious case, and urges a bar, a fine of \$80,000 plus an additional \$71,431.35 (representing five times the amount of funds converted), for a total of \$151,431.35, and a requirement that Smith pay restitution in the amount of \$10,000, plus interest, to EV, and in the amount of \$4,286.27, plus interest, to the estate of LM.

The Hearing Panel agrees that the sanctions requested by Enforcement are appropriate under the undisputed facts of this case. The circumstances are egregious. Global had no real existence, yet the investors were led to believe they were investing in a going concern with an established track record, and that their funds would be invested in emerging businesses. Instead, Smith gave EV's and LM's money to Wall or spent it himself on personal expenses. That he never intended to repay them is evident from the fact that he never bothered to record their addresses or telephone numbers. Apart from Smith's otherwise clean record, there are no apparent mitigating facts. Therefore, the Hearing Panel agrees that the sanctions requested by Enforcement are appropriate in this case.

## **7. Conclusion**

Respondent Frederick D. Smith is censured, barred from associating with any member firm in any capacity, fined a total of \$151,431.35, and ordered to pay restitution

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<sup>5</sup> NASD Sanction Guidelines, p. 34 (1998 ed.).

in the amount of \$10,000, plus interest, to EV and in the amount of \$4,286.27, plus interest, to the estate of LM, for the conversion violation.<sup>6</sup> These sanctions shall take effect on a date set by the Association, but not before the expiration of 45 days from the date of this decision, except that a bar or expulsion shall become effective immediately upon this Decision becoming the final disciplinary action of the Association. The Form U-4 charge is dismissed.<sup>7</sup>

**HEARING PANEL**

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By: David M. FitzGerald  
Hearing Officer

Dated: Washington, DC  
June 2, 1999

Copies to:

Frederick Douglass Smith (via Federal Express and first class mail)  
Joy H. Hansler, Esq. (electronically and via first class mail)  
Rory C. Flynn, Esq. (electronically and via first class mail)

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<sup>6</sup> Interest is payable at the rate set forth in 26 U.S.C. §6621(a)(2), running from the dates the funds were converted, which was December 29, 1995, with respect to EV, and December 19, 1995, with respect to LM, until the funds are repaid. NASD Sanction Guidelines, p. 12 (1998 ed.). The complete names and other identifying information regarding EV and LM are contained in the exhibits that Enforcement filed and served in support of its motion.

<sup>7</sup> The Hearing Panel considered all of the arguments of the parties. They are rejected or sustained to the extent they are inconsistent or in accord with the views expressed herein.