NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. RAGHAVAN SATHIANATHAN (CRD No. 1743692), 6 Meadow Lane Bloomfield, NJ 07003, Respondent.	Disciplinary Proceeding No. C9B030076 Hearing Officer—Andrew H. Perkins **HEARING PANEL DECISION** November 30, 2004

Respondent found liable for (1) making unsuitable recommendations to two customers, in violation of NASD Conduct Rules 2310 and 2110, and (2) exercising discretion without written authority, in violation of NASD Conduct Rules 2510(b) and 2110. Respondent barred from associating with any member firm in any capacity for making unsuitable recommendations. In light of the bar, no further sanctions imposed. Respondent found not liable for omitting material facts in connection with the sale of securities, in violation of Section 10(b) of the Securities Exchange Act of 1934, Exchange Act Rule 10b-5, and NASD Conduct Rules 2120 and 2110.

Appearances

Michael J. Newman and David Klafter, Woodbridge, NJ (Rory C. Flynn, NASD Chief Litigation Counsel, Washington, DC, Of Counsel) for the Department of Enforcement.

Raghavan Sathianathan appeared *pro se*.

DECISION

I. INTRODUCTION

On October 24, 2003, the Department of Enforcement (the "Department") filed a four-cause Complaint against the Respondent Raghavan Sathianathan ("Sathianathan" or the

"Respondent"). The Complaint charged that the Respondent: (1) made unsuitable recommendations to customers AV and SS that they purchase Class B mutual fund shares on margin instead of Class A shares that had lower fees and charges, in violation of NASD Conduct Rules 2310 and 2110 and IM–2310–2; (2) omitted material facts in connection with the sale of Class B shares to customers AV and SS, in violation of Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), Exchange Act Rule 10b-5, and NASD Conduct Rules 2120 and 2110; and (3) engaged in discretionary trading in AV's account without his written authorization, in violation of NASD Conduct Rules 2510(b) and 2110.

On December 15, 2003, the Respondent filed an Answer and Counter-Complaint, in which he requested a hearing. The Counter-Complaint sought sanctions against the NASD attorney and investigator assigned to this disciplinary proceeding. Following the Initial Pre-Hearing Conference, the Hearing Officer dismissed the Counter-Complaint because the NASD Code of Procedure does not provide for counterclaims against NASD or its staff.[1]

The hearing was held at NASD's offices in Woodbridge, NJ, on July 7 and 8, 2004, before a hearing panel composed of the undersigned Hearing Officer, a member of NASD's District 11 Committee, and a member of NASD's District 9 Committee.[2]

II. FINDINGS OF FACT

There are few facts in dispute in this contentious proceeding. Most of the Respondent's effort has been devoted to his specious argument that NASD instituted this proceeding at

[1] Order dated January 7, 2004.

[2] The hearing transcript is referred to as "Tr."; the Department's exhibits as "CX"; and the Respondent's exhibits as "R."

Salomon Smith Barney Inc.'s behest in further retaliation for his reporting to various regulatory and criminal authorities that certain Salomon Smith Barney employees committed perjury during an arbitration with customer AV. Alternatively, Sathianathan contends that the retaliation stems from his refusal to help with Salomon Smith Barney's bad faith defense of AV's arbitration claim. In any event, Sathianathan claims that he is entitled to whistleblower status under The Sarbanes-Oxley Act of 2002[3] ("Sarbanes-Oxley") and that this disciplinary proceeding therefore should be dismissed.[4] By Order dated June 28, 2004, the Hearing Officer rejected this affirmative defense. Nevertheless, the Respondent continued to press the argument throughout the proceeding, and much of the evidence Sathianathan sought to have the Hearing Panel consider related to his Sarbanes-Oxley claim. The Hearing Officer excluded this evidence.[5]

A. The Respondent

Sathianathan joined Salomon Smith Barney as a trainee in August 1998 and registered with NASD as a General Securities Representative in November 1998.[6] Sathianathan left

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[3] Public Law 107-204, 116 Stat. 745. In general terms, Sarbanes-Oxley is a sweeping piece of reform legislation covering the governance of public corporations. Among its provisions are two that establish protections against retaliation by public companies and their officers, managers, and other agents, against employees who "blow the whistle" on securities law and other violations. Section 806 of the Act (codified as 18 U.S.C. § 1514A) creates a right of civil action in federal court that protects whistleblowers against retaliation in securities fraud cases. Section 1107 (codified as 18 U.S.C. § 1513(e)) provides for criminal penalties for retaliation against informants. Neither provision provides the Respondent with an affirmative defense to this disciplinary proceeding.

[4] Sathianathan raised substantially the same claims in a 162-page Complaint he filed against NASD on November 19, 2003, in the United States District Court for the District of New Jersey, Civil Action No. 03-5481(WHW). Sathianathan attached a copy of his federal Complaint as Exhibit B to his Answer and Counter-Complaint. The civil action was still pending at the time of the hearing.

[5] Sathianathan submitted 349 exhibits. The Hearing Officer admitted 203 and excluded the remainder. Pursuant to Procedural Rule 9267(b), all of the excluded documents have been retained and attached to the record of this proceeding. The Hearing Officer had to renumber all of the Respondent's exhibits because he used identical numbers for multiple exhibits. (*See* Order Renumbering the Respondent's Exhibits (Oct. 13, 2004).)

[6] CX1, at 3.

Salomon Smith Barney voluntarily in February 2001 and joined Morgan Stanley DW Inc. ("Morgan Stanley"). From March 2, 2001, to February 14, 2002, Sathianathan was registered with NASD as a General Securities Representative through his association with Morgan Stanley. Currently, Sathianathan is neither registered with NASD nor associated with an NASD member firm.[7]

B. Customer AV

In 2000, AV was a 29-year-old computer system engineer with Juniper Networks, Inc., a technology company that manufactures high-speed switch routers for the Internet. Juniper was a relatively new company, and investment in its stock posed significant risk. Salomon Smith Barney had initiated research coverage of Juniper in July 2000, giving it a "buy, speculative rating."[8] Salomon Smith Barney forecasted Juniper's quarter-to-quarter revenue growth at 30% or more, and its potential price appreciation at 54%.[9] At the time, like many of its peers in the technology sector, investors saw Juniper as a momentum stock, which resulted in a high degree of price volatility. The Department's Exhibit CX15, a chart of its price and volume movement between April 2000 and September 2001, shows the stock's volatility. Over this period, the stock went from $233 per share to less than $10 per share.

In April 2000, AV opened an account with Salomon Smith Barney at its Menlo Park, California office.[10] AV had very limited investment experience; he was not a sophisticated

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[7] CX1; Tr. at 74.

[8] R138. Juniper had completed its initial public offering in 1999 and listed on NASDAQ.

[9] *See* R142.

[10] Tr. at 79.

investor.[11] However, through Juniper's incentive stock option plan, AV had accumulated a substantial amount of Juniper stock.[12] The new account application reflects that he earned $100,000 per year, had a net worth of $1.5 million, had a moderate risk tolerance, and excluded speculation from his investment objectives.[13]

Shortly after AV opened the Salomon Smith Barney account, Sathinathan's brother introduced him to Sathianathan. On May 4, 2000, Sathianathan sent an email to AV confirming that he would be in California towards the end of May 2000 and that he would be available then to meet with AV and some of his friends who also might need "sophisticated financial advice."[14] Sathianathan emphasized that he was qualified to give such sophisticated advice because he held an MBA degree from a top-ten business school[15] and had worked as a risk management consultant for a Fortune 500 company before joining Salomon Smith Barney. Sathianathan described his role as providing solutions to complex financial problems faced by high net worth individuals. Sathianathan further stated that his "immediate focus … would be to protect [AV's] current wealth and then use asset allocation and other more sophisticated techniques to diversify [his] investment portfolio so as to protect and grow [the] portfolio in a systematic and controlled manner."[16] Sathianathan did not disclose that he only had about one year's experience and still was in a trainee program.

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[11] *Id.* at 78, 312.

[12] *Id.* at 77–78.

[13] CX3.

[14] CX7, at 2.

[15] Sathianathan claimed to have graduated from the business school at Duke University.

[16] CX7, at 2.

In May 2000, AV opened an account with Sathianathan, who worked in Salomon Smith Barney's Little Falls, New Jersey office. At that time, Sathianathan completed a new account application for AV with a substantially revised investor profile. The new application reflects that AV's net worth was $10 million, his annual income was $90,000, his risk tolerance was aggressive, and his investment objectives included speculation.[17] Although Sathianathan knew that AV was not interested in aggressive, speculative investments, Sathianathan marked AV's application in this manner so that he could participate in the high technology stock boom and purchase options to hedge the account.[18] Sathianathan explained that this was necessary because Salomon Smith Barney did not allow options trading in an account unless the account was classified aggressive and speculative.[19] At his on-the-record interview, Sathianathan testified that he routinely marked his customers' accounts as aggressive and speculative, regardless of the customers' stated objectives and preferences, because that would allow him to recommend the broadest range of investments.[20] Sathianathan did not grasp the importance of making only suitable recommendations to his customers. As he testified:

> Even in cases where some of them said moderate, I would tell them, let's get real. You know, if you want to buy some tech stock–this was like say in [1999], NASDAQ was shooting through the roof, if you want to buy a tech stock, you cannot say moderate, you have to say aggressive. I did not realize … that all those forms or this particular aggressive stuff and all that is like very important in terms

[17] CX3.

[18] Tr. at 317.

[19] *Id.*

[20] Ex. CX2, at 45. (All references to Sathianathan's on-the-record interview transcript are cited to the transcript page number, not the exhibit page number.)

> of determining liability and all that. I had no idea. Let's put it this way, … I didn't realize that this was treated as very important.[21]

In AV's case, Sathianathan further stated that he did not link AV's account documentation to AV's stated objective—preservation of wealth.[22]

1. Sathianathan's Recommendation that AV Purchase Class B Shares

Although AV's primary goal was to diversify his holdings, Sathianathan recommended that AV defer selling any of his Juniper stock until February 2001 when any sale would be eligible for long-term capital gains tax treatment.[23] By deferring the sale, Sathianathan estimated that AV's tax on the sale would be cut in half.[24] In addition, based entirely on historical market trends, Sathianathan believed that Juniper's stock price would rise in the last quarter of 2000 following the broad decline of technology stocks in September 2000.[25] Sathianathan thought the worst had occurred and that the market usually rallied at the end of the year.[26] Accordingly, to diversify AV's account and hedge the risk associated with such a concentrated position, Sathianathan recommended that AV purchase mutual funds (Class B and L shares) and an index warrant on margin, using his Juniper stock as collateral.[27] AV had no cash in his account.[28] Sathianathan made the recommendation to purchase mutual funds because he believed it

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[21] *Id.* at 45–46.

[22] *Id.* at 47.

[23] Tr. at 334.

[24] *Id.* Sathianathan estimated that the applicable tax rate would go from 40% to 20%.

[25] *Id.* at 89–90; 337–38.

[26] *Id.* at 337–38.

[27] *Id.* at 83.

[28] *Id.* at 93.

involved less risk than purchasing stocks.[29] With respect to the risk of using margin, Sathianathan testified that he did not consider it a realistic possibility that AV would have to sell any of his Juniper stock due to a margin call. In his words, the risk was equivalent to a "meteorite hitting New York City tomorrow."[30]

2. The Class B Shares Purchased on September 26, 2000

AV accepted Sathianathan's recommendations. On September 26, 2000, Sathianathan purchased $200,000 of Class B shares in each of 14 growth mutual funds[31] for a total investment of $2.8 million.[32] Before the purchases, the only securities in AV's account were 60,500 shares of Juniper stock valued at approximately $13.8 million.[33]

Sathianathan testified that he divided the purchases of Class B shares among 14 funds because Salomon Smith Barney would not permit a registered representative to purchase more than $250,000 of Class B shares for a single customer, and Sathianathan only wanted to purchase Class B shares.[34] By dividing the investment in this manner, Salomon Smith Barney's computer system could not detect and block the transactions.

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[29] *Id.* at 435.

[30] *Id.* at 338.

[31] The 14 funds Sathianathan purchased were: Kemper New Europe Fund, Oppenheimer Global Growth & Income Fund, Nuveen Innovation Fund, Pimco Innovation Fund, Seligman Global Technology Fund, Alliance Premier Growth Fund, Fortis Captial Appreciation Fund, Aim Value Fund, Davis New York Venture Fund, Nvest Star Small Cap Fund, Dreyfus Founders Discovery Fund, Fidelity Advisor Technology Fund, Guardian Park Avenue Fund, and MFS Strategic Growth Fund.

[32] Tr. at 86–87; Ex. CX5, at 13–14; Ex. CX27, at 2.

[33] Ex. CX5. The closing price of Juniper stock on September 25, 2000, was $227.88 per share. (Ex. CX15, at 10.)

[34] Tr. at 88–89.

Commonly, mutual funds, including those in the fund families at issue here, offer more than one class of shares. Each class participates in the same portfolio of investments and is identical to the other classes, except for differing sales loads, expenses, and the commission credits paid to the broker-dealer. For example, a fund may offer classes with different sales charges, such as one class with a front-end load and lower fees, and another class with a back-end load and higher fees. In this proceeding, the Department focuses on Classes A and B offered by each of the funds Sathianathan purchased.[35]

Class A shares typically levy an initial sales charge or front-end load, which is taken out of the customer's purchase price before the investment goes into the fund. Mutual funds generally discount sales charges based on the size of a customer's purchase. The levels at which the discounts become effective are called breakpoints. Breakpoints can be attained either in a single purchase or over a period of months pursuant to a letter of intent or rights of accumulation. A letter of intent is a statement signed by the investor indicating his intent to purchase a certain amount of fund shares over a stated period. A right of accumulation is the discount or breakpoint received in a current mutual fund transaction based on the cumulative value of previous transactions. In either case, the other purchase transactions that are credited towards the discount may occur in accounts that are related or linked to the investor and in different mutual funds that are part of the same fund family.[36] In this proceeding, each of the

[35] Sathianathan also purchased Class L shares in one fund, which purchase is discussed in Section II.B.3 below.

[36] *See* NASD Notice to Members 02-85, 2002 NASD Lexis 96, at *4–5 (Dec. 2002).

funds Sathianathan recommended offered breakpoints at various levels and waived the initial sales charge for purchases of $1 million or more.[37]

On the other hand, Class B shares generally do not levy an initial sales charge. However, Class B shares usually are subject to higher annual expenses than Class A shares. In addition, Class B shares commonly impose a Contingent Deferred Sales Charge (CDSC) where an investor sells the shares before the end of a designated period. They usually occur on a declining basis, based on the length of time the shares are owned, and typically are eliminated after six to eight years. The funds Sathianathan recommended imposed CDSCs that decreased each year.[38] In addition, because of the higher expenses associated with Class B shares, many mutual funds limit purchases in Class B shares to $250,000. Several of the funds Sathianathan purchased had such restrictions.[39]

The owners of Class A and Class B shares periodically pay expenses, including "12b-1" fees.[40] The expense ratios charged to Class B shareholders are generally higher than the expense ratios charged to Class A shareholders. At the end of an investor's CDSC period in Class B shares, the Class B shares convert to Class A shares. Conversion to Class A shares lowers the annual expenses to the same level as the Class A rate.

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[37] *See* Ex. CX17.

[38] *Id.*

[39] *See, e.g.*, Ex. CX17, at 66 (Seligman Global Technology Fund prospectus).

[40] The annual operating charges included distribution fees (also referred to as 12b-1 fees) and management fees. Rule 12b-1 under the Investment Company Act of 1940, 17 C.F.R. § 270.12b-1, permits an investment company to use its funds to distribute securities if the shareholders and a majority of the board, including a majority of the independent directors, adopt a written plan of distribution that complies with the Rule.

The primary advantage of Class B shares is that sales charges may be reduced or avoided altogether, depending on the investor's holding period of the shares. Moreover, the absence of a front-end load means that 100% of the customer's funds are invested. For small investments, Class B shares are considered more advantageous than Class A shares because small investments in Class A shares do not qualify for any breakpoints and incur the highest initial sales charge rate. The primary disadvantage of Class B shares is that their annual expense ratios are significantly higher than those for Class A shares.

A registered representative receives an immediate commission credit when fund shares are purchased, regardless of the class. Thus, there is no incentive for a representative to recommend Class B shares based solely on the timing of his receipt of the commission credit. However, there is a substantial difference in the amount of commission credit a registered representative receives for selling Class B versus Class A shares of the same fund. This occurs because a representative receives a declining rate of commission credits at breakpoints for the sale of Class A shares, but the same percentage commission credit for the sale of all Class B shares, regardless of dollar amount. In this case, Sathianathan received higher commission credits on the purchase of the Class B shares than he would have earned on the purchase of Class A shares in the same funds. As discussed below, this was the primary factor behind Sathianathan's recommendations.

3. The Class L Shares Purchased on September 26, 2000

On September 26, 2000, Sathianathan also purchased $500,000 worth of Class L shares in a new growth fund offered by Salomon Smith Barney, the Smith Barney Spectrum Fund.[41] Sathianathan testified at his on-the-record interview that he bought the Class L shares because he felt pressured by Salomon Smith Barney to purchase some of its funds.[42] Sathianathan, however, did not favor Salomon Smith Barney funds because he considered them to have poorer performance records than other available funds. He selected the Spectrum Fund because it was new; therefore, it did not have a record of accomplishment. In addition, he felt that he could sell the fund in a few years if it underperformed its peers. The Spectrum Fund Class L shares also were purchased on margin.[43]

4. The Index Warrants Purchased on September 29, 2000

In addition, on September 29, 2000, Sathianathan purchased 200,000 index warrants issued by Salomon Smith Barney Holdings, Inc. (the "Warrants") for $1 million.[44] According to the prospectus, the Warrants were call warrants based on the 2000 TEN+ Index, a diversified basket of common stocks of 15 corporations.[45] The Chicago Board Options Exchange calculates and publishes the TEN+ Index and restricts sale of warrants in the index to investors whose

[41] The fund did not begin trading until the end of October 2000. For that reason, the purchase appears on AV's October account statement. (Tr. at 96; Ex. CX5, at 24.)

[42] Tr. at 177–78; Ex. CX2, at 57–58.

[43] Tr. at 91.

[44] Ex. CX5, at 14.

[45] Ex. CX16.

accounts have been approved for options trading.[46] Investment in the Warrants involved a high degree of risk.[47] At his on-the-record interview, Sathianathan testified that he recommended the Warrants to AV because they carried a 6% sales commission.[48] Sathianathan offered no alternative explanation for his selection of such a high-risk investment. Notably, the purchase of this investment ran contrary to Sathianathan's story that he recommended investments to temper the risk in AV's account stemming from the concentrated Juniper stock position.

5. Sathianathan's Recommendation to Purchase Additional Class B Shares in December 2000

Contrary to Sathianathan's assumptions, the market continued to decline in October, November, and December 2000. Consequently, in December 2000, Sathianathan recommended that AV purchase additional mutual fund shares to "average down the cost" of his investment.[49] Sathianathan reasoned that AV had only one month to go before he could sell his Juniper stock and eliminate his margin balance. Moreover, Sathianathan believed that the market would rally in January 2001. Once again, AV relied on Sathianathan's advice. On December 29, 2000, AV purchased an additional $400,000 of Class B shares and $200,000 of Class C shares,[50] which brought AV's total mutual fund investment to $3.9 million, all of it on margin.[51]

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[46] *Id.* at 6.

[47] *Id.* at 2.

[48] Tr. at 116–17.

[49] Tr. at 342.

[50] Sathianathan purchased $200,000 worth of Class B shares in Oppenheimer International Growth Fund and Pilgrim Worldwide Growth Fund, and $200,000 of Class C shares in Fidelity Advisor Small Cap Fund. (Ex. CX27, at 2.) These funds carried fees and charges and offered other share classes similar to the funds Sathianathan purchased for AV's account in September 2000. Sathianathan testified in his on-the-record interview that the purchase of Class C shares was an error; he had meant to purchase Class B shares. (Tr. at 90.)

[51] The mutual fund shares comprised approximately 53% of the total market value of AV's account.

The remainder of AV's account was comprised of the Warrants, worth approximately $950,000, and 47,000 shares of Juniper stock. AV's Juniper stock holdings had been reduced by 13,500 shares on November 30, 2000, to correct an error in the account. Salomon Smith Barney had erroneously credited AV's account with 13,500 too many shares in connection with a stock split in June 2000. Consequently, the market value of AV's Juniper stock at the close on December 29, 2000, was approximately $5.9 million.[52]

6. Sales of Mutual Fund Shares and the Warrants due to Margin Calls in AV's Account

Juniper's stock price continued to decline into 2001, which resulted in margin calls in AV's account. At Sathianathan's recommendation, AV sold the Warrants and the mutual fund shares to meet the margin calls.[53] As a result, AV incurred losses in excess of $1 million and deferred contingent sales charges in excess of $100,000.[54] Sathianathan did not recommend that AV sell any Juniper stock because Sathianathan continued to believe that the price of Juniper stock would rebound.

Sathianathan admitted that his recommendation to use Juniper stock as margin collateral was a mistake.[55] At his on-the-record interview, Sathianathan stated, "I made a stupid recommendation. My bad recommendation was not so much - - I bought the mutual funds, it was actually buying them on margin."[56] Later in his on-the-record interview, he further explained:

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[52] Ex. CX5, at 29; Ex. CX15, at 8.

[53] Tr. at 93–94.

[54] *Id.* at 94.

[55] *Id.* at 106.

[56] Ex. CX2, at 69.

> This is where I screwed up [on AV's account]. I basically screwed up in September. The initial set of recommendations where instead of getting [AV] to [protect his] net worth, instead I said, look, we can wait until February and instead - - in the meantime the market is going to go up, we can diversify [using] margin. I screwed that up ….[57]

Sathianathan resigned from Salomon Smith Barney on February 16, 2001, and became associated with Morgan Stanley. In April and May 2001, AV transferred his account from Salomon Smith Barney to Morgan Stanley.[58]

7. Sathianathan's Exercise of Discretion without Written Authorization

At Morgan Stanley, on May 29, 2001, and June 8, 2001, Sathianathan purchased 23,000 shares of Juniper stock in AV's account without AV's authorization. AV was in India at the time and unaware of the purchase. The total cost of the purchase was $1,005,156.83.[59] Sathianathan made these purchases in an effort to recoup some of the losses AV had suffered due to the sell-off to meet the margin calls in his account. Although Sathianathan claimed that he had time and price discretion, it is clear that he did not.[60] Sathianathan admitted that he never discussed specific prices and timing with AV. Rather, Sathianathan concluded that AV agreed with Sathianathan's overall recommended strategy that AV should try to recover his losses by purchasing Juniper stock when the price was low and then selling when the price rose.[61] Sathianathan argued that this mutual "understanding" provided sufficient discretion to support the purchase.

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[57] *Id.* at 80.

[58] Ex. CX5, at 70, 76.

[59] Ex. CX27, at 6.

[60] Ex. CX2, at 130–45.

C. Customer SS

In 2000, SS was a computer programmer with Juniper. Like AV, he had received company stock through Juniper's incentive stock option plan.[62] He also had limited investment experience.[63]

AV introduced Sathianathan to SS, and, in May 2000, SS moved his principal Salomon Smith Barney account to New Jersey with Sathianathan as his financial consultant.[64] The new account application Sathianathan completed reflects that SS's net worth was $2 million, his annual income was $500,000, his risk tolerance was aggressive, and his investment objectives included speculation.[65] The application was incorrect in a number or material respects. Although Sathianathan marked the account as suitable for aggressive and speculative investments, SS was not interested in either. In fact, SS opposed maintaining any margin balances in his account, and he frequently instructed Sathianathan to eliminate any such balances when SS discovered them.[66] SS's main objective was protection of his net worth and diversification of his holdings, which Sathianathan understood.[67] In addition, SS's annual income was about $100,000, not $500,000.[68]

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[61] *Id.*

[62] Tr. at 99; CX2, at 98.

[63] CX2, at 97–98.

[64] SS Decl., Ex. CX14, at ¶ 4. By December 2000, SS had consolidated all of his Salomon Smith Barney accounts with Sathianathan. (*Id.* ¶ 5.)

[65] Ex. CX12.

[66] SS Decl., Ex. CX14, at ¶¶ 8–9.

[67] CX2, at 98–99.

[68] *Id.* at 99–100.

SS came to rely on Sathianathan's investment advice because he repeatedly assured SS that he was an expert in risk management and that SS could trust his experience and expertise.[69] Indeed, Sathianathan stated in his on-the-record interview that SS moved his account to Sathianathan because he could protect his net worth and because Sathianathan had an MBA degree from Duke University.[70]

SS's account statement for June 2000 reflects that the net value of his account was $3.3 million, of which $2.86 million was Juniper stock.[71] The remainder of the account was comprised of $251,258 in mutual funds, $47,600 in unit investment trusts, $40,788 in municipal bonds, and $103,902 in cash.[72]

In August or September 2000, SS specifically asked Sathianathan for a recommendation on how to protect the value of his Juniper stock.[73] Sathianathan told SS that he could do so by placing a collar around the stock.[74] Although SS did not understand collars, he requested Sathianathan to proceed, relying on Sathianathan's representation that this strategy would protect the value of SS's Juniper stock.[75] At the time, Juniper stock was trading at approximately $200 per share.[76] But Sathianathan did not follow SS's instruction.[77]

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[69] SS Decl., Ex. CX14, at ¶ 7.

[70] Ex. CX2, at 99.

[71] CX13, at 1. SS held 19,224 shares of Juniper common stock in his account with Sathianathan.

[72] *Id.*

[73] SS Decl., Ex. CX14, at ¶ 12.

[74] *Id.* ¶ 13.

[75] *Id.* ¶ 12. The collar is a two-part option strategy. The first part of a collar is a protective put. The second part is a covered call. Covered calls are calls that are sold on a share-for-share basis against owned stock. The primary purpose of a collar is protection of profits accrued from underlying shares. To establish a collar, the investor purchases a protective put and writes a covered call on the underlying stock. Generally, the put and the call are both

When SS asked Sathianathan why he did not place the collars around his Juniper stock, Sathianathan told him that he was sure that the price of Juniper stock would rise in late 2000.[78] Sathianathan sent SS an email detailing the strategy he intended to follow, which was to keep everything concentrated in Juniper stock.[79] Sathianathan said that he would pick the correct time and price to sell SS's stock.[80] In the meantime, Sathianathan advised SS to buy additional shares of Juniper stock.[81]

In November 2000, SS found a house he wanted to purchase. Accordingly, SS instructed Sathianathan to sell enough Juniper stock so that he would have the needed funds on hand in December 2000 when the purchase was scheduled to close. Sathianathan advised SS not to purchase the house. Nevertheless, SS persisted and bought the house. But, because Sathianathan had not sold any Juniper stock, he did not have the needed cash on hand. Thus, SS was forced to purchase the house using his Salomon Smith Barney credit line.[82]

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out-of-the-money (i.e. the put option strike price is lower than the current market price, and vice versa for the call option) when this combination is established, and have the same expiration month. Both the buy and the sell sides of this spread are opening transactions, and are always the same number of contracts. In other words, one collar equals one long put and one written call along with owning 100 shares of the underlying stock. The disadvantage of a collar is the limit it places on the stock's profit potential. The covered call establishes a ceiling on how much can be made from a price rise in the stock as the stock must be sold or covered at the call strike price.

[76] SS Decl., Ex. CX14, at ¶ 12.

[77] *Id.* ¶ 13.

[78] *Id.* ¶ 14.

[79] *Id.* ¶¶ 14–15.

[80] *Id.*

[81] *Id.* ¶ 16.

[82] *Id.* ¶ 21.

Also in December 2000, Sathianathan made the same recommendation to SS as he had to AV—to purchase mutual funds on margin.[83] SS followed Sathianathan's recommendation to purchase the mutual funds, but SS insisted that Sathianathan sell a portion of his Juniper holdings to fund the purchases. SS did not want to use margin in his account. Consequently, on December 26 and 28, 2000, SS sold 11,000 shares of Juniper stock for approximately $1.262 million and applied the proceeds to the purchase of $1.750 million worth of Class B shares in 11 mutual funds.[84] He purchased $150,000 of Class B shares in nine funds, and $200,000 of Class B shares in two funds.[85] Sathianathan testified at his on-the-record interview that he did not perform any further analysis in picking the funds for SS's account. He picked good funds from the funds he had purchased for AV in September.[86] Sathianathan made no suitability determination for SS, he simply recommended the same strategy that he had recommended to AV—hold the Juniper stock and purchase Class B mutual fund shares.

SS's account statement for December 31, 2000, following the mutual fund purchases, reflects that the net value of his account was $2.55 million. The account contained: Juniper stock, valued at $2.69 million;[87] mutual funds, valued at $1.99 million; unit investment trusts,

[83] Tr. at 371–72.

[84] Ex. CX27, at 4.

[85] *Id.*

[86] Ex. CX2, at 102.

[87] On December 4, 2000, SS transferred an additional 13,126 shares into this account. The transfer increased the number of shares in the account to 21,350 shares. (Ex. CX13, at 23.)

valued at $30,883; and municipal bonds, valued at $41,108.[88] In addition, SS had an outstanding loan of $2.21 million.[89]

III. CONCLUSIONS OF LAW

A. Unsuitable Recommendations—NASD Conduct Rule 2310

NASD Conduct Rule 2310(a) provides that, in recommending a purchase of a security to a customer, a broker "shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and financial situation and needs." Moreover, a representative must "make reasonable efforts to obtain information concerning: (1) the customer's financial status; (2) the customer's tax status; (3) the customer's investment objectives; and (4) such other information used or considered to be reasonable by such … registered representative in making recommendations to the customer."[90]

A broker's recommendations must be consistent with his customer's best interests.[91] A broker violates Conduct Rule 2310 if there is a showing that he lacked reasonable grounds for believing that his recommendation of a particular security was suitable for a customer or he failed to obtain information concerning the suitability of his recommendation before executing the transaction.[92]

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[88] Ex. CX13, at 20.

[89] *Id.*

[90] NASD Conduct Rule 2310(b).

[91] *Wendell D. Belden*, Exchange Act Release No. 47,859, 2003 SEC LEXIS 1154, at *11 (May 14, 2003).

[92] *See District Bus. Conduct Comm. v. Moore*, No. C01970001, 1999 NASD Discip. LEXIS 27, at *12-13 (N.A.C. Aug. 9, 1999) (finding respondent liable for failing to consider customers' overall financial situation, level of investment experience, sophistication, or financial needs).

In the case of mutual funds, NASD has directed its members "to consider all of the expenses charged, and discounts offered, by a mutual fund in determining whether the purchase of that fund's shares is suitable."[93] And, immediately before the transactions in question, NASD issued a release specifically advising its members against recommending that large investors purchase Class B shares because of the lower sales charges and discounts that are frequently available to the purchasers of Class A shares.[94]

1. Unsuitable Recommendations to AV

The Complaint alleged that Sathianathan made unsuitable recommendations to AV in connection with his purchases of mutual funds. There is no dispute that Sathianathan recommended the transactions or that AV totally relied on him.[95] Sathianathan characterized AV as an unsophisticated investor.[96] AV, who was 29 when he opened the account, lacked the knowledge and experience to make an independent judgment regarding his account and Sathianathan's recommendations. Sathianathan claimed, however, that the degree to which AV acquiesced in all of Sathianathan's recommendations declined after he joined Morgan Stanley.[97] But, even if true, this would not excuse Sathianathan from his obligation to recommend only suitable transactions. "The test for whether [Sathianathan's] recommended investments were

[93] *Belden,* 2003 SEC LEXIS 1154, at *13.

[94] *Suitability Issues for Multi-Class Mutual Funds*, NASD REGULATORY AND COMPLIANCE ALERT (Summer 2000).

[95] Tr. at 313.

[96] Tr. at 312–13. Sathianathan considered AV's sophistication level to be so low that Sathianathan rejected the idea of using privately managed accounts to diversify the account. (Tr. at 461–62.) In Sathianathan's estimation, he needed to introduce AV to the concept of diversification using mutual funds before he could introduce the added complexity of managed accounts. (*Id.)*

[97] Tr. at 313.

suitable is not whether [AV] acquiesced in them, but whether [Sathianathan's] recommendations to [AV] were consistent with [his] financial situation and needs."[98]

Based on the totality of the circumstances surrounding Sathianathan's recommendations, the Hearing Panel concludes that Sathianathan did not take into account AV's investment objectives, overall financial situation, level of investment experience, sophistication, and financial needs. Rather, the evidence shows that Sathianathan recommended an unsuitable and self-serving investment strategy to AV.

(a) Failure to Properly Evaluate the Higher Costs of Class B Shares

Sathianathan did not evaluate properly and adequately the relative expenses, fees, and discounts associated with the Class A and Class B shares of the mutual funds Sathianathan recommended. By his own account, Sathianathan made the decision to purchase Class B shares with no more than a cursory analysis of their comparative costs. Sathianathan testified that he made a simple calculation that took him no more than five minutes and determined that the Class B shares were better.[99] In essence, Sathianathan compared the annual Class B expenses to the up-front sales charges on the Class A shares.[100] Sathianathan did not consider, however, the attendant margin risk that could force an early sale of the funds if Juniper fell in value. In addition, Sathianathan disregarded the CDSCs because he recommended that AV hold the mutual funds for the long term.[101] And he disregarded the breakpoints that could have been

[98] *Belden*, 2003 SEC LEXIS 1154, at *11 (citations omitted).

[99] Tr. at 347, 355.

[100] *Id.* at 346–47.

[101] Tr. at 352–53. Sathianathan told AV that the CDSCs should be given minimal consideration because of the low probability they would be incurred. (Tr. at 464.)

achieved by consolidating the investments in Class A shares of fewer funds because he was unwilling to limit his recommendation to four or less fund families. Thus, Sathianathan's strategy required that he sacrifice the cost savings that he could have attained by consolidating the purchases and taking advantage of the funds' breakpoints.[102] Consequently, AV did not receive any breakpoints or other discounts that would have been available if he had purchased Class A shares.[103]

Sathianathan hypothesized that he needed to purchase 10-15 funds to achieve appropriate diversification, and, if he limited his choice to a few fund families, he therefore would have to make selections from some of the families' poorer performing funds.[104] According to Sathianathan, he based this hypothesis on his vague conception that to attract investors a mutual fund family will favor one of its funds at the expense of others within the same family.[105] Hence,

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[102] Tr. at 470.

[103] The Department submitted a hypothetical analysis to demonstrate the potential cost savings that AV could have realized if he had invested $4 million in four fund families, assuming a holding period of eight years. Using the calculator NASD provides on the NASDR.com Internet site, the total savings would have amounted to approximately $240,000. (Ex. CX27, at 10–11.) Sathianathan did not make a similar analysis.

[104] Tr. at 339–41, 468–71.

[105] Tr. at 469. To support his hypothesis, Sathianathan pointed to two academic studies, published in 2003 and 2004, that concluded that mutual fund families have an incentive to selectively favor their well performing funds in order for them to continue to exhibit abnormal performance and thereby increase the inflows accruing to the entire family. (Ex. R131 and R132 (formerly marked as exhibits Vol. II, No. 31 and 32).)Although these studies had not been published at the time he made his recommendations to AV, Sathianathan argued that he was aware generally of the contributing market forces identified in these two studies.

Sathianathan reasoned, the most beneficial approach to diversification was to cherry pick the top performing funds from the selected fund families and shun their other poorer performing funds, which might have been used to subsidize their top funds. But Sathianathan made no effort to determine whether his assumptions were true. Sathianathan selected funds based on their reputation and their Morningstar ratings. Sathianathan never computed the comparative net returns between purchasing Class A shares in fewer fund families and purchasing Class B shares in multiple fund families.[106] And, significantly, Sathianathan made no analysis of the suitability of his recommendations.

Moreover, the unequivocal evidence establishes that Sathianathan intentionally circumvented both Salomon Smith Barney's and some funds' restrictions on purchasing large amounts of Class B shares.[107] He also purposefully violated Salomon Smith Barney's Mutual Funds Sales Practices Compliance Manual, which generally prohibits the sale of Class B shares where the client could obtain volume discounts by purchasing Class A shares.[108]

(b) Unsuitable Use of Margin

Sathianathan's recommended use of margin trading in AV's account also was unsuitable.

> Trading on margin increases the risk of loss to a customer for two reasons. First, the customer is at risk to lose more than the amount invested if the value of the security depreciates sufficiently.… Second, the client is required to pay interest on the margin loan, adding to the investor's cost of maintaining the account and

[106] Consequently, the Hearing Panel does not reach the issue of whether he could have satisfied his suitability obligation if he had made such a comparative analysis.

[107] Tr. at 340–41.

[108] Ex. CX18, at 8. At the hearing, Sathianathan testified that he had never seen Salomon Smith Barney's Mutual Fund Sales Practices Compliance Manual. (Tr. at 381.) Sathianathan also claimed that Salomon Smith Barney gave him little or no training regarding mutual funds. (Tr. at 520.)

increasing the amount by which his investment must appreciate before the customer realizes a net gain.[109]

Sathianathan attempted to defend his use of margin by contending that AV made an informed decision to accept Sathianathan's recommendation. Sathianathan contended that he disclosed in general terms the risks associated with margin trading and that he presented several hedging strategies for AV's consideration. The record shows, however, that Sathianathan did little more than summarily present AV with information regarding the costs of several products offered by Salomon Smith Barney's Global Equities Derivatives Department.[110] There is no evidence that Sathianathan fully explained the risks associated with any of the strategies, including his recommended use of margin. The Hearing Panel finds that Sathianathan's limited discussion did not satisfy his duty under Conduct Rule 2310. "Although it is important for a broker to educate clients about the risks associated with a particular recommendation, the suitability rule requires more from a broker than mere risk disclosure."[111] A broker must ensure that the customer understands the risks involved in a recommended securities transaction.

Moreover, the evidence demonstrates that Sathianathan gave little consideration to the immediate use of any of the hedging strategies offered by the Derivatives Department. He had determined that he should defer implementing any hedging strategy until no earlier than February 2001, when AV would be entitled to long-term capital gains tax treatment on the sale of Juniper stock. The Hearing Panel further notes that, before he purchased the Class B shares

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[109] *Department of Enforcement v. Jack H. Stein,* No. C07000003, 2001 NASD Discip. LEXIS 38, *15 (N.A.C. Dec. 3, 2001) (quoting *Rangen*, 52 S.E.C. at 1307-08 (1997)).

[110] Tr. at 327–29, 333.

and the Warrants, Sathianathan did not seek any advice from the Derivatives Department regarding the suitability of these strategies to AV's overall financial situation. Sathianathan considered such input worthless because he viewed himself to be as knowledgeable about the products and strategies as anyone in the Derivatives Department even though he had just one year's experience as a financial consultant.[112]

In any event, even if AV understood the risks associated with margin trading and chose, notwithstanding the risks, to pursue it, the Hearing Panel concludes that AV's financial situation and investment objectives did not substantiate the increased risk to which Sathianathan's margin trading exposed AV's account.[113] Sathianathan was under a duty to advise AV against the use of margin because the strategy was incompatible with his acknowledged needs.[114] Sathianathan violated that duty. The extent to which Sathianathan used margin to effect transactions in AV's account was unsuitably risky given AV's level of experience and stated investment objectives.[115]

(c) Unsuitable Recommendation to Purchase the Warrants

Finally, Sathianathan's recommendation to AV that he purchase the Warrants also was unsuitable. As discussed above, the Warrants were a risky investment. In fact, the Warrants had the potential to expire worthless. They were suitable only for investors who could tolerate the

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[111] *Department of Enforcement v. James B. Chase,* No. C8A990081, 2001 NASD Discip. LEXIS 30, at *17 (N.A.C. Aug. 15, 2001) (citing *Patrick G. Keel*, 51 S.E.C. 282, 286 (1993)).

[112] Tr. at 327–28.

[113] *Department of Enforcement v. Jack H. Stein,* No. C07000003, 2001 NASD Discip. LEXIS 38, *15 (N.A.C. Dec. 3, 2001) (citations omitted).

[114] *See, e.g., Charles W. Eye*, 50 S.E.C. 655, 659 (1991).

[115] *Stephen Thorlief Rangen*, 52 S.E.C. 1304, 1307–08, 1997 SEC LEXIS 762, at *9 (1997).

higher risk associated with options trading. AV was not such a customer. Moreover, Sathianathan was obligated to satisfy himself that AV understood the risks associated with the Warrants and that he was both able and willing to take those risks. The record does not establish that Sathianathan attempted to satisfy himself in such a manner.[116]

(d) Conclusion Regarding Sathianathan's Recommendations to AV

In sum, Sathianathan was obligated to tailor his recommendations to AV's financial situation and needs. However, Sathianathan's recommendations did not meet his obligation to make customer-specific determinations of suitability in terms of the types of securities, the concentration of securities, and the use of margin. Based upon AV's investment experience, financial condition, and needs, Sathianathan's recommendations that AV purchase the Class B mutual fund shares and the Warrants on margin were unsuitable and violated Conduct Rule 2310. Sathianathan's conduct also violated Conduct Rule 2110 because it violated the high standards of commercial honor and just and equitable principles of trade demanded by Conduct Rule 2110.

2. Unsuitable Recommendations to SS

Sathianathan's recommendations to SS similarly were unsuitable. Without making any suitability determination, Sathianathan recommended that SS retain all of his Juniper stock and purchase Class B mutual fund shares on margin. When SS insisted that he did not want to employ margin, Sathianathan proceeded to sell a portion of SS's Juniper stock and purchase $1.75 million of Class B shares in 11 mutual fund families.

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[116] *District Bus. Conduct Comm. v. Igor Cherednichenko*, No. C01960013, 1997 NASD Discip. LEXIS 49, *16–17 (N.B.C.C. Sept. 5, 1997).

Sathianathan did not evaluate the relative expenses, fees, and discounts associated with the Class A and Class B shares of the mutual funds he recommended. Sathianathan simply selected 11 funds from among those he had purchased in AV's account. He based his selection on his general knowledge of the fund families, not on an analysis of which funds would be more beneficial to SS.[117] Sathianathan never considered the breakpoints that could have been achieved by consolidating the investments in Class A shares of fewer funds because he had made the decision that under no circumstances would such consolidation be advantageous to any investor. Consequently, SS did not receive any breakpoints or other discounts that would have been available if he had purchased Class A shares.[118]

Moreover, the unequivocal evidence establishes that Sathianathan intentionally circumvented both Salomon Smith Barney's and some funds' restrictions on purchasing large amounts of Class B shares, as he had with the purchases for AV.[119] He also purposefully violated Salomon Smith Barney's Mutual Funds Sales Practices Compliance Manual, which generally prohibits the sale of Class B shares where the client could obtain volume discounts by purchasing Class A shares.[120]

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[117] CX2, at 106.

[118] The Department submitted a hypothetical analysis to demonstrate the potential cost savings that SS could have realized if he had invested in one fund family, assuming a holding period of eight years. Using the calculator NASD provides on the NASDR.com Internet site, the total savings would have amounted to approximately $139,953. (Ex. CX27, at 13.) Sathianathan did not make a similar analysis.

[119] Tr. at 340–41.

[120] Ex. CX18, at 8.

Sathianathan was obligated to tailor his recommendations to SS's investment objectives, overall financial situation, level of investment experience, sophistication, and financial needs. However, Sathianathan's recommendations did not meet his obligation to make customer-specific determinations of suitability. To the contrary, Sathianathan's recommendations were motivated by his desire to increase his commissions. In conclusion, Sathianathan's recommendations that SS purchase the Class B mutual fund shares were unsuitable and violated Conduct Rule 2310. Sathianathan's conduct also violated Conduct Rule 2110 because it violated the high standards of commercial honor and just and equitable principles of trade demanded by Conduct Rule 2110.

B. Fraudulent Omissions Not Proven

To establish that Sathianathan violated the antifraud provisions of the federal securities laws and NASD rules as charged, the Department must prove by a preponderance of the evidence that he either made material misrepresentations, or omitted material information, in connection with the purchase, sale, or offer of securities. The Department also must prove that he acted with scienter.[121]

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[121] Section 10(b) of the Exchange Act, makes it unlawful in connection with the purchase or sale of any security, for any person, directly or indirectly to use or employ "any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe…." Exchange Act Rule 10b-5 renders it unlawful for any person: (a) to employ any device scheme or artifice to defraud, (b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or (c) to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person.

NASD Conduct Rule 2120 prohibits the use of any manipulative, deceptive, or other fraudulent device or contrivance to effect a transaction in, or induce the purchase or sale of, any security. NASD Conduct Rule 2120 is the equivalent of Exchange Act Rule 10b-5. *Market Regulation Comm. v. Shaughnessy*, No. CMS950087, 1997 NASD Discip. LEXIS 46, at *24 (N.B.C.C. June 5, 1997).

The Complaint alleges that Sathianathan violated Section 10(b) of the Exchange Act, Exchange Act Rule 10b-5, and NASD Conduct Rules 2120 and 2110 by omitting to disclose the following facts:

(1) Certain large investments in Class A shares of mutual funds entitle the customer to take advantage of breakpoints, which provide for discounts on sales charges that are not available for investments in Class B shares.

(2) Class B shares are subject to higher ongoing operating expenses, primarily due to 12b-1 fees and CDSCs, to which Class A shares generally are not subject.

(3) AV and SS could have consolidated their investments in mutual funds with similar objectives into a single mutual fund to obtain the benefit of breakpoint discounts through the purchase of Class A shares of the single fund.

(4) AV and SS could have purchased Class A shares of the same mutual fund families through the use of letters of intent and rights of accumulation and thereby obtained breakpoint discounts.[122]

Because AV and SS provided limited cooperation to the Department, it was left to rely on Sathianathan's on-the-record testimony to prove the alleged fraudulent omissions. Principally, the Department relied on two excerpts where Sathianathan stated that he had not discussed the option of obtaining breakpoints with AV and SS because breakpoints were not the focus of Sathianathan recommendations.[123] In essence, the Department characterized these statements as

[122] Compl. ¶ 18.

[123] Ex. CX2, at 64, 107–08.

Sathianathan's admissions that he had violated the antifraud provisions of the federal securities laws.[124] But in isolating the statements in the manner it did, the Department failed to consider the context of the statements. In each instance, Sathianathan was explaining why he had not provided detailed information to his customers about breakpoints. At other points in his on-the-record interview, Sathianathan stated that he had told AV about the existence of breakpoints. Moreover, Sathianathan repeated this contention at the hearing where he testified that he calculated the differing costs and reviewed them with both customers.[125] With respect to AV's account, Sathianathan specifically testified:

> Question: In your own words, what information did you go over with [AV] with regard to the decision to purchase Class B shares?
>
> Answer: I - - - we talked about the different classes of mutual funds: A shares, B shares, C shares. And I told him about the trade off of A shares between the up-front charges for A shares versus the higher operating expenses of B shares.
>
> Question: Did you quantify those differences, or did you talk about them in general terms that they were higher?
>
> Answer: I quantified and also showed him that with the higher volume purchases, he gets a breakpoint reduction in the thing. He fully understood that. And also briefly I discussed the thing about sticking all the money in one mutual fund, so he didn't have to pay any A share up-front things.[126]

In conclusion, the Hearing Panel finds Sathianathan's testimony to be ambiguous. While it is clear that Sathianathan did not make a proper suitability determination that took into consideration the effect the higher Class B costs would have on the anticipated return on investment, the Department has not proved that he failed to mention each of the facts alleged in

[124] *See* Department's Pre-Hearing Submission at 13.

[125] Tr. at 347–48, 452–53.

the Complaint. Indeed, when Sathianathan's testimony is taken as a whole, it appears likely that he did mention each of the facts the Complaint alleges he omitted. And, with no other evidence in the record regarding what the customers were told, the Hearing Panel concludes that the Department failed to prove the alleged omissions by a preponderance of the evidence. Consequently, the Hearing Panel will dismiss the Third Cause of Action.

C. Sathianathan's Exercise of Discretion without Written Authorization

NASD Conduct Rule 2510(b) prohibits a registered representative from exercising any discretionary power in a customer's account unless such customer has given prior written authorization and the representative's firm has accepted the account.[127] Sathianathan concedes that he did not have written discretionary authority for AV's account at Morgan Stanley. At the hearing, Sathianathan claimed that he did not need written authorization because AV had given him oral time and price discretion to repurchase 33,000 shares of Juniper stock in an effort to mitigate the losses AV had suffered in his account.[128] But, on August 6, 2001, Sathianathan sent an email responding to AV's complaint about the unauthorized activity in his account.[129] In that email, Sathianathan states that he bought back shares of Juniper while AV was in India "purely based on what [he] thought was a strong family relationship that [he and AV had] through the fact that one of [AV's] best friends is [Sathianathan's] brother."[130] At no point in this email did

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[126] Tr. at 434.

[127] *See, e.g., Paul F. Wickswat*, 50 S.E.C. 785 (1991).

[128] NASD Conduct Rule 2510(d)(1) provides that the Rule shall not apply to "discretion as to the price at which or the time when an order given by a customer for the purchase or sale of a definite amount of a specified security shall be executed."

[129] Ex. CX11, at 3.

[130] *Id.* at 4.

Sathianathan claim to have time and price discretion. Accordingly, the Hearing Panel finds that Sathianathan violated NASD Conduct Rules 2510(b) and 2110, as charged in the fourth cause of the Complaint.

IV. SANCTIONS

A. Unsuitable Recommendations

The NASD Sanction Guidelines ("Guidelines") for unsuitable recommendations suggest a fine of $2,500 to $75,000. In addition, the Guidelines recommend a suspension of 10 business days to one year. For egregious cases, the Guidelines direct the adjudicator to consider imposing a longer suspension or a bar.[131]

The Hearing Panel finds Sathianathan's misconduct to be egregious and orders that he be barred in all capacities. Sathianathan demonstrated a profound lack of understanding of his customer-specific suitability obligation under NASD Conduct Rule 2310. Sathianathan blatantly disregarded his customers' financial situations and needs, abused their trust, and recommended investments to increase his commissions. In addition, after examining Sathianathan's conduct in light of the Principal Considerations contained in the Guidelines, the Hearing Panel finds numerous aggravating factors that justify a bar in this case. Foremost is Sathianathan's refusal to accept responsibility for his misconduct and his attempt to shift his responsibilities as a registered representative to his former firms and supervisors.[132] Moreover, Sathianathan has engaged in a continuing effort to blame others for his customers' losses. Viewing his strident and

[131] NASD SANCTION GUIDELINES 97 (2004 ed.).

[132] Principal Consideration No. 2, Guidelines 8.

unyielding claims as a whole, the Hearing Panel concludes that any sanction short of a bar would not affect Sathianathan's future conduct.

Sathianathan placed his own interests in garnering commissions above his customer's interests, thereby violating his fundamental obligation of fair dealing.[133] In an eight-page letter to AV's attorney dated July 28, 2002, which Sathianathan wrote in connection with AV's arbitration claim against Salomon Smith Barney,[134] Sathianathan candidly admitted that he recommended that AV purchase Class B mutual fund shares because the resulting commissions were important to him.[135] From Sathianathan's perspective, mutual funds were desirable because he would get immediate commissions, and Class B shares were preferable because they paid a higher commission than Class A shares.[136]

Circumstantial evidence further supports the Hearing Panel's conclusion. For example, Sathianathan testified in his on-the-record interview that commissions similarly played a role in his recommendation that AV purchase the Warrants, which paid a 6% sales commission.[137] Without doubt, Sathianathan gave this rich commission considerable weight in recommending that AV purchase the Warrants. In addition, as a broker trainee at Salomon Smith Barney, Sathianathan had been on a combined salary and commission compensation plan for his first 13

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[133] *Belden*, 2003 SEC LEXIS 1154, at *14 n.14.

[134] Sathianathan wrote the letter to assist AV's expert witness in putting together the damage claim against Salomon Smith Barney. Sathianathan blamed Salomon Smith Barney for the losses AV suffered.

[135] Ex. CX21, at 1. Sathianathan also explained that Salomon Smith Barney's compensation plan influenced him to recommend against selling assets because he made more by having more assets under management. (*Id.* at 5.)

[136] Tr. at 146.

[137] Sathianathan testified, "I saw the six percent [commission] and I looked at it and I liked it." (Ex. CX2, at 76.)

months. Thereafter, his salary stepped down each month until it ended in October 2000.[138] Consequently, at the time he was advising AV and SS, earned commissions were of paramount importance to Sathianathan because they represented 100% of his compensation.[139] In addition, AV's and SS's accounts were by far his two largest.

Based on the forgoing, the Hearing Panel concludes that commissions were the predominant factor underlying Sathianathan's recommendations. Sathianathan did not consider properly and adequately AV's and SS's financial needs and investment objectives in making his recommendations.

The Hearing Panel further notes that Sathianathan has demonstrated a complete refusal to conform to the rules governing the securities industry. For example, in September 1999, Salomon Smith Barney had placed Sathianathan on probation for his failure to maintain the highest levels of professional and ethical behavior.[140] The probation letter specifically addressed Sathianathan's failures to employ and maintain proper portfolio management. The letter directed Sathianathan to eliminate his use of options and margin, to eliminate excessive trading and commissions, and to employ appropriate diversification and risk management in customer accounts.[141] Despite these admonitions, Sathianathan employed the very same unsuitable strategies in AV's and SS's accounts, to their severe detriment.[142]

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[138] Ex. CX20, at 1.

[139] Ex. CX20.

[140] Ex. CX25.

[141] *Id.*

[142] *See* Principal Consideration No. 15, Guidelines 9.

The Hearing Panel also was troubled greatly by Sathianathan's intentional evasion of all of the restrictions designed to prohibit an investor from purchasing more than $250,000 in Class B mutual fund shares. As discussed above, Sathianathan deliberately structured AV's and SS's investments to circumvent Salomon Smith Barney's policies and system limitations on purchasing large amounts of Class B shares.[143] In doing so, Sathianathan showed no regard for his customers' welfare; instead, he demonstrated a mind-set that is antithetical to the high ethical standards demanded of securities professionals.

Sathianathan's callous disregard for his clients and the rules governing his conduct are further illustrated by his admission that he marked his clients' accounts as aggressive and speculative no matter what they told him about their investment objectives and risk tolerance. More importantly, Sathianathan did so because he used margin and options trading in his clients' accounts without consideration of the suitability of those strategies for his customers. This is a grave departure from the standards governing his duty to ensure that his recommendations are suitable for his customers.

In summary, Sathianathan's "flagrant disregard for the rules of the securities industry and his continuous attempts to avoid taking responsibility for his actions demonstrate the threat that his continued employment in the industry holds."[144] Accordingly, to protect the investing public and prevent his further disregard of the standards that govern the securities industry, the Hearing

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[143] *See* Principal Consideration No. 13, Guidelines 9.

[144] *See Department of Enforcement v. Dane S. Faber*, No. CAF010009, 2003 NASD Discip. LEXIS 3, at *40 (N.A.C. May 7, 2003), *aff'd, Dane S. Faber*, Exchange Act Release No. 49,216, 2004 SEC LEXIS 277 (Feb. 10, 2004).

Panel will bar Sathianathan in all capacities. In light of the bar, the Hearing Panel will not impose a fine.[145]

B. Exercise of Discretion without Written Authorization

The Guidelines for exercising discretion without written authorization recommend a fine of $2,500 to $10,000, plus the amount of the respondent's financial benefit from the transactions, and, in egregious cases, a suspension of 10 to 30 business days.[146] The Guidelines list as principal considerations in determining sanctions for these violations: (1) whether the customer's grant of discretion was express or implied, and (2) whether the firm's policies prohibited discretionary trading and whether the firm prohibited respondent from exercising discretion in customer accounts.

AV never explicitly gave Sathianathan power to exercise discretion in trading his account. In addition, Morgan Stanley's policies prohibited discretionary accounts, which Sathianathan knew. Accordingly, a sanction at the upper end of the recommended range would be appropriate in this case. However, in light of the bar imposed for the suitability violations, an additional suspension would not serve any purpose. Therefore, the Hearing Panel will not impose a separate sanction for this violation. A suspension would be redundant,[147] and a monetary fine would serve no additional remedial purpose.[148]

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[145] The Hearing Panel will not order restitution because the Department had not introduced sufficient evidence from which the Hearing Panel could determine the customers' losses.

[146] Guidelines 92.

[147] *Department of Enforcement v. Hodde*, No. C10010005, 2002 NASD Discip. LEXIS 4, at *17 (N.A.C. Mar. 27, 2002).

[148] *See, e.g.*, *Department of Enforcement v. Castle Securities Corp*., No. C3A010036, 2004 NASD Discip. LEXIS 1, at *36–37 (N.A.C. Feb. 19, 2004).

V. ORDER

Raghavan Sathianathan is barred permanently from associating with any member firm in any capacity for making unsuitable recommendations, in violation of NASD Conduct Rules 2510(b) and 2110. The Respondent is not further sanctioned for exercising unauthorized discretion in AV's Morgan Stanley account.

In addition, Sathianathan is ordered to pay costs in the amount of $4,198.30, including an administrative fee of $750 and hearing transcript costs of $3,448.30.

These sanctions shall become effective on a date set by the NASD, but not earlier than 30 days after this Decision becomes the final disciplinary action of the NASD, except that the bar shall become effective immediately if this Decision becomes the final disciplinary action of NASD.

Finally, the Hearing Panel dismisses the Third Cause of Action, which charged that Sathianathan omitted material facts in connection with the sale of Class B mutual fund shares to customers AV and SS, in violation of Section 10(b) of the Exchange Act, Exchange Act Rule 10b-5, and NASD Conduct Rules 2120 and 2110. The Department failed to prove these violations by a preponderance of the evidence.[149]

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Andrew H. Perkins
Hearing Officer
For the Hearing Panel

[149] The Hearing Panel has 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.

Copies to:

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