NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. BRIAN J. KELLY (CRD No. 2270427), Respondent.	Disciplinary Proceeding No. E9A2004048801 Hearing Officer – DRP **PANEL DECISION** July 12, 2007

Respondent is barred from association with any member firm in any capacity for: (1) churning a customer's account, in violation of Section 10(b) of the Securities Exchange Act and Rule 10b-5 promulgated thereunder, NASD Conduct Rules 2120 and 2110, and (2) recommending unsuitable trading in the customer's account, in violation of NASD Conduct Rules 2310, 2110 and IM-2310-2. In light of the bars, no additional sanctions are imposed for exercising discretion in the customer's account without the firm's written approval, in violation of NASD Conduct Rules 2510(b) and 2110.

Appearances

For the Department of Enforcement: David Newman, Regional Counsel, Philadelphia, PA (Rory C. Flynn, Esq., Washington, DC, Of Counsel).

For the Respondent: Kevin F. Arthur, Esq., Kramon & Graham, P.A., Baltimore, MD.

Decision

I. Procedural History

The Department of Enforcement filed a three-count Complaint on June 2, 2006, charging that from in or about May 2001 to in or about July 2002, Brian J. Kelly churned the account of customer GM; recommended trading that was unsuitable for GM, based on the frequency of trades and excessive use of margin; and exercised discretionary power in GM's account without the firm's written approval.

Kelly filed an Answer asserting that the trading he recommended was not excessive in light of GM's goals and objectives. In addition, Kelly denied using excessive margin and exercising discretion in GM's account without prior written approval from his firm. He requested a hearing.

On April 11-12, 2007, a two-day hearing was held in Washington, DC, before a hearing panel composed of the Hearing Officer, a member of NASD's District 9 Committee, and a member of NASD's District 11 Committee. Enforcement called two witnesses: customer GM and Respondent's former branch manager, Matthew K. Glenn. Enforcement also introduced sixteen exhibits in evidence.[1] Kelly offered three exhibits and testified on his own behalf.[2] The parties stipulated to the annualized turnover rate, commission-to-equity ratio and cost-to-equity ratio in GM's account during the relevant period.[3]

II. Findings of Fact and Conclusions of Law

A. Respondent Brian J. Kelly

Brian J. Kelly (Kelly or Respondent) graduated from Washington College in 1990 with a degree in business and psychology. He has worked in the securities industry for 15 years and is currently registered with NASD member Ferris, Baker Watts (Ferris, Baker) as a general securities representative in the firm's Annapolis, MD office. Prior to joining Ferris, Baker, Respondent was associated with several other member firms, including Merrill Lynch,

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[1] CX-1 – CX-15 and CX-A are in evidence.

[2] RX-2, RX-A and RX-B are in evidence.

[3] References to the hearing transcript are noted as Tr. Enforcement's exhibits are cited as CX, Respondent's exhibits are cited as RX, and the joint stipulation is cited as Stip.

Alex. Brown, and First Union Securities (First Union), a predecessor to Wachovia Securities (Wachovia).[4] (Tr. 329-30; Stip.)

When Respondent joined First Union in 1998, he was placed under special supervision for one year due to his mishandling of a discretionary account at his previous firm. Because Respondent was an aggressive trader, his branch manager maintained heightened scrutiny of Respondent's accounts until approximately January 2001. Respondent testified that during the period relevant to the Complaint, his work became "somewhat careless and sloppy," which he attributed to his wife's serious medical situation. (Tr. 162-65, 223, 316-17, 359; CX-A; Stip.)

For the last nine years, Respondent has hosted a local call-in radio show about stocks and investment ideas. During the period relevant to the Complaint, Respondent primarily discussed "hot stocks" on his weekly show. (Tr. 170, 335-36, 384.)

B. Customer GM

After listening to Respondent's radio show for several weeks, GM contacted Respondent in 2000 or early 2001 to arrange a meeting. GM, who was then 56 years old, had retired from Bethlehem Steel after working as a mill mechanic for twenty-seven years. At the time, GM was a self-made businessman who owned a pretzel store in a mall in Glen Burnie, MD, and assisted people seeking to establish pretzel businesses in other states. GM also helped oversee construction projects in residences his son had purchased in Baltimore to rehabilitate and resell. (Tr. 31-35, 79-80, 85-88, 97-98, 144, 222-23; CX-1.)

When GM first met Respondent, he had a brokerage account at Alex. Brown worth approximately $250,000. Most of the account was invested in money market and mutual funds. According to GM, he did not know "too much" about stocks and "always relied on whoever was

[4] Kelly is subject to NASD jurisdiction, because he was registered with a member firm at the time of the alleged violations (First Union) and when Enforcement filed the Complaint (Ferris, Baker).

taking care of my account to give me advice and tell me what needed to be done and when . . . ." (Tr. 31, 36-38, 338, 340; CX-3.)

Though Respondent denies having made such a claim, GM testified that during their initial meeting, Respondent said he achieved a 50% return for his clients, even in a down market. In February 2001, GM closed his Alex. Brown account and opened two accounts with Respondent at First Union.[5] Respondent testified that before GM opened his accounts, he fully explained his investment philosophy and day trading strategy to GM. According to Respondent, GM "wanted to get involved in" day trading. Respondent conceded, however, that GM may not have been aware that day trading involved buying and selling stocks on the same day and does not believe he discussed with GM "the costs" associated with this strategy, i.e., commissions. For his part, GM testified that he believed day trading meant trading during "normal" hours, as opposed to trading after hours. (Tr. 38, 74-75, 339, 341-43, 345, 420-21; CX-1 - CX-3.)

C. Trading in GM's Account

Prior to opening his First Union account, GM told Respondent that he had "medium" or "moderate" risk tolerance. His February 2001 account application reflects his moderate risk tolerance, as well as an investment objective of growth. The application form also shows that GM had an annual income between $100,000 and $199,999, net worth between $500,000 and $999,999 (excluding residence), and average knowledge of stocks and mutual funds. (Tr. 36-37, 40-42; CX-1.)

GM signed, but did not complete, the application form. According to GM, his annual income in early 2001 was approximately $50,000 to $60,000, and his net worth was closer to $500,000, a figure that included his residence. Furthermore, though the form states in tiny print

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[5] In addition to a personal account, GM also opened an IRA account that is not the subject of this Complaint. (Tr. 60-61; CX-4.)

that all qualified accounts are opened as margin accounts, GM testified that he did not know much about margin at the time and did not recall discussing margin with Respondent. According to Respondent, he explained margin to GM and believed the customer understood the concept. (Tr. 40-41, 43-46, 100-101, 173-74, 343-44; CX-1.)

At first, Respondent discussed proposed trades with GM. GM's personal circumstances soon changed, however, and it became difficult to reach him by telephone. As a result, Respondent asked GM for authority to effect trades on his behalf. To that end, GM signed a discretionary trading authorization form on April 11, 2001. GM testified that he immediately saw a substantial increase in customer confirmations, which eventually prompted him to question Respondent about why he was "trading so much" and "buying and selling so quickly." According to GM, Respondent explained that this level of trading activity was required to "make money." (Tr. 49-52, 347-49; CX-6.)

Before Respondent could trade GM's account on a discretionary basis, however, he was required by First Union to obtain three levels of approval: from his branch manager, regional director, and Compliance.[6] Though Respondent's branch manager, Matthew Glenn (Glenn), approved discretionary trading in GM's account on April 12, the assistant to the regional director did not sign the discretionary trading form until June 15. (Tr. 165-66, 177-78; CX-5, CX-6.)

During April, May and June 2001 -- before Compliance had acted on the request for discretionary authority -- Respondent used margin to effect 115 purchases worth approximately $3.6 million in GM's account, causing GM to incur approximately $1,700 in margin interest

[6] Not only was this requirement made explicit in the firm's written procedures, but in bolded text, it was noted that "Compliance must accept the account before discretion is exercised." (CX-5.)

charges.[7] During this period, Respondent also effected 99 sales, for a total of 214 trades in three months.[8] (CX-3.)

Respondent conceded that he exercised discretion in GM's account during this period. Respondent testified that he believed Glenn's approval was sufficient to use discretion in the account until he was notified in July that the account was "no longer approved for discretion."[9] (Tr. 352-53, 395.)

On July 10, 2001, Compliance rejected discretionary trading in GM's account, citing the level of trading activity and losses in the account. Compliance also placed a 90-day freeze on day trading in GM's account and directed Glenn to "thoroughly discuss" with Respondent the account's trading activity, as well as the customer's goals and objectives. (Tr. 178-79, 354; CX-7.)

Respondent testified that he met with GM in August 2001 to discuss investment philosophy and strategy.[10] According to Respondent, GM asked to be more involved with the account, and as a result, Respondent then called GM before every trade. Respondent admitted,

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[7] On May 14, 2001, a margin activity report was generated due to the significant margin balance ($396,288) and level of margin debt ($201,588.57) in GM's account. (Tr. 211-12; CX-14.)

[8] GM deposited $100,000 in the account on April 20, 2001, for the purchase of a variable annuity. Respondent contends, and Glenn testified, that the conservative nature of the annuity "balanced out" GM's portfolio. (Tr. 60, 105, 238; CX-3.)

[9] Glenn testified that during this period, Respondent asked several times if GM's account was approved for discretionary trading. The Panel believes that Glenn fabricated this testimony in an effort to assist Respondent and to cover up his own shortcomings as a supervisor who improperly permitted Respondent to actively trade GM's account while approval for discretionary authority was pending. Even Respondent disputed Glenn's testimony on this issue. (Tr. 179, 427.)

[10] Respondent testified that he asked Glenn to attend the August 2001 meeting. According to Glenn, he met briefly with GM in August 2001 and concluded that it was GM's decision to day trade a portion of his account. In Glenn's view, GM was "accustomed to risk" and "liked the excitement." Not only did GM deny telling Glenn that the trading in his account was exciting, but Respondent's notes indicate that during this meeting, he and GM discussed "staying put for the next three months." Of course, Respondent failed to tell GM that he was obligated to discontinue day trading at this time due to the prohibition instituted by Compliance. Nevertheless, Respondent's notes lend support to GM's testimony, and the Panel once again rejects Glenn's testimony. (Tr. 233, 239, 355, 400-401; CX-7; RX-2.)

however, that he never told GM that his account had not been approved for discretion. (Tr. 355-56, 370-72, 400-403.)

GM's testimony differed from Respondent's. According to GM, once he authorized Respondent to exercise discretion in his account, months passed without any contact. On the few occasions when GM and Respondent spoke, GM testified that they primarily discussed the amount of trading, and losses, in the account. According to GM, Respondent assured him that "the money will come back." GM trusted Respondent and believed that "everything [would] wind up being okay."[11] (Tr. 52-53, 103-104.)

Shortly after the freeze ended in October, Respondent resumed day trading GM's account. During November and December 2001, Respondent effected a total of 87 trades (47 purchases and 40 sales) in GM's account, selling many stocks for a loss or after a slight increase in the stock price. By the end of 2001, Respondent had bought $5.69 million worth of securities, and collected $5.58 million in proceeds from securities sold. Since February, the account value had dropped approximately $57,000 or 20 percent.[12] (CX-3.)

In early January 2002, Glenn sent GM a request to update his account objective from moderate growth to aggressive growth. When GM failed to respond, Glenn sent a follow-up letter regarding short-term trading in GM's account. Glenn asked GM to sign and return an acknowledgement that it was GM's "trading objective (notwithstanding previously stated or recorded account objectives) to effect short-term transactions in securities . . . recognizing that

[11] The Panel credits GM's testimony on this point, because GM was more credible than Respondent in general. Moreover, the level of trading in the account, and Respondent's admitted failure to inform GM that Compliance rejected the use of discretion, renders Respondent's testimony that he called GM before every trade unbelievable.

[12] If not for the annuity purchased in April, the decline in account value would have been steeper.

such trading involves risk of financial loss and may generate substantial commission charges." (CX-8.)

GM testified that he "wasn't really positive that [he] wanted to sign" the acknowledgement and did not fully understand Glenn's letter. Nevertheless, on March 4, 2002, GM signed an acknowledgement prepared by the firm, which stated that GM was "fully aware of the level of activity, commissions paid, interest charges . . . and overall profits and losses" in his account and that all transactions were made in accordance with his investment objectives. GM never changed his risk tolerance or investment objective, however, which remained moderate growth. Even Respondent conceded that the appropriate risk tolerance for a customer seeking to day trade was aggressive. (Tr. 65-68, 119-126, 190-93, 204, 245-46, 280-81, 389-90; CX-8; RX-B.)

In July 2002, Respondent purchased two mutual funds for GM, but otherwise ceased trading his account.[13] Both GM and Respondent attribute the switch to a discussion they had about mutual funds after GM's daughter told him that mutual funds were a more stable investment. (Tr. 68-73, 96-97, 252, 375-76; CX-3.)

Almost two years later, GM formally complained about Respondent's handling of his account. In a letter dated March 23, 2004, GM wrote to Glenn, protesting that the level of trading in his account in 2001 was unsuitable in light of his investment objectives and risk tolerance. In August 2004, GM's attorney filed a written complaint with NASD regarding Respondent's handling of GM's account. GM subsequently filed an arbitration claim against

[13] Glenn claimed that he directed this switch because GM failed to update his account forms to reflect the aggressive trading in his account. The Panel rejects this explanation, which was contradicted by both GM and Respondent. Much of Glenn's testimony was self-serving, and in the Panel's view, not credible.

Wachovia and Respondent, which was ultimately settled. Respondent contributed to the settlement. (Tr. 133, 384; CX-9, CX-10.)

From May 1, 2001 through July 31, 2002, purchases totaling $7.79 million were made in GM's account. Respondent received $33,291.41 in net commissions from these trades.[14] The account value declined by approximately $90,000, and the total margin interest charged was $3,378.58.[15] During the relevant period, the annualized turnover rate in GM's account was 30.18, commission-to-equity ratio was 33.14%, and cost-to-equity ratio was 34.45%. (CX-3; Stip.)

At the hearing, Respondent conceded that the trading in GM's account was not suitable for a person of GM's means and income and may not have been suitable for any of his clients. Respondent expressed "deep regret for . . . any actions that [he] took that led to losses for" GM. Respondent testified that he has not engaged in this type of trading in many years and that the "situation that occurred with [GM] . . . will not happen again." He further testified that, since registering with Ferris, Baker in 2004, he has again been subject to special supervision. According to Respondent, he is required to document every phone conversation with every client and prohibited from placing trades without his manager's approval. (Tr. 382-83, 385-88, 390, 405, 417-18, 433.)

D. Discussion

The charges considered by the Hearing Panel were whether Respondent: (1) churned GM's account, in violation of Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder, NASD Conduct Rules 2120 and 2110; (2) recommended unsuitable trading in GM's

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[14] GM paid $85,510.15 in gross commissions, representing almost 10% of gross commissions paid by Respondent's customers during the relevant period. (Stip.)

[15] Glenn attributed losses in GM's (and all customers') accounts to declining market conditions during this period. (Tr. 225-27, 232.)

account, in violation of NASD Conduct Rules 2310, 2110 and IM-2310-2; and (3) exercised discretion in the account without the firm's written approval, in violation of NASD Conduct Rules 2510(b) and 2110.

1. Churning

Churning violates the antifraud provisions of the Exchange Act[16] and NASD Conduct Rules 2120 and 2110.[17] "Churning occurs when a securities broker buys and sells securities for a customer's account, without regard to the customer's investment interests, for the purpose of generating commissions."[18] Churning has been found where the broker exercised control over an account, trading was excessive in light of the investment objectives, and the broker acted with intent to defraud or with reckless disregard for the interests of the customer.[19] The Panel finds that Enforcement established all three elements.

a. Control

Control is established if the account is discretionary, or if the broker exercises *de facto* control of the account.[20] *De facto* control of an account may be shown when the client does not understand the trading activity in his or her account or routinely follows the broker's advice.[21]

In April 2001, GM gave Respondent written authority to exercise discretion in his account. Though the firm did not approve discretionary trading for the account, Respondent

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[16] *Donald A. Roche*, Exchange Act Rel. No. 38742, 1997 SEC LEXIS 1283 (June 17, 1997).

[17] Rule 2120, NASD's anti-fraud rule, parallels SEC Rule 10b-5. *Dep't of Enforcement v. U.S. Rica Financial, Inc.*, No. C0100003, 2003 NASD Discip. LEXIS 24, *14, n.5 (NAC Sept. 9, 2003).

[18] *Sandra K. Simpson*, Exchange Act Rel. No. 45923, 2002 SEC LEXIS 1278, at *52 (May 14, 2002), quoting *Olson v. E.F. Hutton & Co.*, 957 F.2d 622, 628 (8th Cir. 1992) (other citations omitted).

[19] *See Dep't of Enforcement v. Castle Securities*, No. C3A010036, 2004 NASD Discip. LEXIS 1, at *14 (NAC Feb. 19, 2004); *Roche*, 1997 SEC LEXIS 1283, at *12-13.

[20] *Peter C. Bucchieri*, Exchange Act Rel. No. 37218, 1996 SEC LEXIS 1331 (May 14, 1996).

[21] *Dist. Bus. Conduct Comm. v. Gliksman*, No. C02960039, 1999 NASD Discip. LEXIS 12, at *24 (NAC Mar. 31, 1999).

concedes that he exercised discretion from April to July 2001. Respondent further admits that he never informed GM of the firm's decision to reject discretion, which lends credence to GM's testimony that he had infrequent contact with Respondent once he authorized discretionary trading in April 2001.

Respondent, who testified that after Compliance rejected discretionary trading he phoned GM before every trade, disputes GM's testimony. However, the Hearing Panel finds in general that GM's testimony was credible and was often corroborated by documents or by Respondent himself.[22] On this point in particular, the Hearing Panel fully credits GM's testimony, as the sheer volume of trades makes it difficult to believe that Respondent spoke with GM prior to every trade.

Furthermore, there is no evidence to suggest that GM did anything other than rely on Respondent to trade his account. Thus, even if the Panel were to credit Respondent's testimony that he frequently phoned GM about trades, the customer was not directing the trading in his account. Rather, he relied on Respondent for advice. Accordingly, the Hearing Panel finds that Respondent controlled GM's account throughout the relevant period.

b. Excessive Trading

Several factors, including the turnover rate, the cost-to-equity ratio, "in and out" trading, and the number and frequency of trades in an account may provide a basis for a finding of

[22] Though GM was clearly not a sophisticated investor, the Panel found his attempts to downplay his business experience and acumen somewhat disingenuous. Otherwise, the Panel finds that GM testified credibly. His testimony was consistent and forthright, and having settled his claims against Respondent and the firm, he had no stake in the outcome of this hearing.

excessive trading.[23] It is generally recognized that an annual turnover rate of six reflects excessive trading,[24] though lower rates may provide "strong support" for a finding of liability.[25]

The parties stipulated that for the relevant period, the annualized turnover rate in GM's account was 30.18, the commission-to-equity ratio was 33.14%, and the cost-to-equity ratio was 34.45%.[26]

The high turnover rate alone reflects excessive trading. This finding is further supported by high commission-to-equity and cost-to-equity ratios, which measure the amount an account must appreciate on an annual basis to cover commissions and other costs.[27]

Turning to the investment objectives, the new account form lists growth as GM's primary investment goal and describes his risk tolerance as moderate. The level of trading in GM's account was well beyond what would have been appropriate for an investor with similar objectives and risk tolerance. Moreover, Respondent admitted that the amount of trading was not suitable for a person of GM's means and income -- and may not have been suitable for any of his clients.

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[23] *Gliksman*, 1999 NASD Discip. LEXIS 12, at *25 (other citations omitted).

[24] *Bucchieri*, 1996 SEC LEXIS 1331, at *11, n.11, citing *Mihara v. Dean Witter & Co., Inc.*, 619 F.2d 814, 821 (9th Cir. 1980).

[25] *See, e.g.*, *Roche*, 1997 SEC LEXIS 1283 (turnover rates of 3.3, 4.6 and 7.2); *Michael H. Hume*, Exchange Act Rel. No. 35608, 1995 SEC LEXIS 983 (Apr. 17, 1995), citing *Samuel B. Franklin & Co.*, Exchange Act Rel. No. 7407, 1964 SEC LEXIS 562 (Sept. 3, 1964) (turnover rates of 3.5 and 4.4).

[26] The turnover rate is calculated using the "Looper Formula," named after *Looper & Co.*, 38 SEC 294 (1958), which involves dividing the total cost of purchases made during a given period by the average monthly investment. In accounts that primarily hold securities rather than cash, such as GM's, a modified Looper formula is used, which involves dividing the total cost of purchases by the average monthly equity. *See Dep't of Enforcement v. Stein*, No. C07000003, 2001 NASD Discip. LEXIS 38, at *16, n.15 (NAC Dec. 3, 2001), citing *Allen George Dartt*, 48 SEC 693 (1987).

[27] *Frederick C. Heller*, Exchange Act Rel. No. 31696, 1993 SEC LEXIS 14, at *4 (Jan. 7, 1993) (excessive trading is established by a high cost-equity ratio, i.e., costs associated with operating the account, commissions plus margin interest); *see also Dep't of Enforcement v. O'Hare*, No. C9B030045, 2005 NASD Discip. LEXIS 39, at *13 (NAC Apr. 21, 2005) (cost-to-equity ratio of 20% generally indicates excessive trading) (citation omitted).

The Hearing Panel concurs and finds that the level of trading activity in GM's account was excessive and at odds with the customer's financial needs and objectives. The high turnover rate, commission-to-equity and cost-to-equity ratios support this conclusion, and the Panel finds there was excessive trading in GM's account.

c. Scienter

For excessive trading to constitute churning, Respondent must have acted with scienter. The critical issue is whether the volume of transactions, in light of the nature and objectives of the account, was so excessive it indicates the broker's intention to profit at his customer's expense.[28] As discussed, the volume of trading in the account was excessive.

Respondent employed short-term or day trading throughout the relevant period, and even including the 90-day prohibition on day trading, he effected 541 trades in GM's account in little more than a year.[29] Though GM occasionally earned a small profit on a particular trade, he often sustained a loss.[30] Each transaction generated a commission for the firm and Respondent, however.

Respondent testified that he explained his investment philosophy and strategy to GM, and Glenn claimed that the customer was excited by this aggressive approach. While GM may have moved his account from Alex. Brown because he wanted to try some of the ideas Respondent espoused on his radio show, there is no evidence that GM understood day trading or the risks inherent in Respondent's approach. It was Respondent who chose to pursue this course of action, despite GM's moderate risk tolerance and questions about the level of activity and

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28 *Dep't of Enforcement v. Castle Securities*, No. C3A010036, 2004 NASD Discip. LEXIS 1, at *14-15, (NAC Feb. 19, 2004), *citing Costello v. Oppenheimer & Co.*, 711 F.2d 1361, 1368 (7th Cir. 1983).

29 CX-3.

30 *Id.*

mounting losses in the account, and it was Respondent who continued trading in this manner until the customer put an end to it.

The Hearing Panel finds that Respondent employed an extremely aggressive and risky strategy of trading that was particularly questionable in a declining market. The volume of transactions and the short-term trading by Respondent generated substantial commissions for him and his firm, but was detrimental to his customer and at odds with GM's financial needs and investment objectives. Respondent abused his control of the account and acted with reckless disregard of his customer's best interest.[31] The Panel finds that the volume of transactions in GM's account was so excessive that Respondent intended to profit at his customer's expense.

Accordingly, the Hearing Panel finds that Respondent acted with scienter and churned the account, in violation of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, as well as NASD Conduct Rules 2120 and 2110, as charged in the first cause of the Complaint.[32]

2. Unsuitability

A registered representative must have a reasonable basis for believing that a recommended transaction is suitable based on the customer's investment objectives and financial situation.[33] Suitability usually refers to the quality of the recommended security, but the quantity

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[31] Recklessness has been held sufficient to satisfy the scienter requirement of Section 10(b), Rule 10b-5 and NASD Conduct Rule 2120. *See, e.g., Dep't of Enforcement v. Fiero*, No. CAF980002, 2002 NASD Discip. LEXIS 16, at *62 (NAC Oct. 28, 2002).

[32] A violation of an SEC or NASD rule also constitutes a violation of Conduct Rule 2110's ethical obligation to observe high standards of commercial honor and just and equitable principles of trade. *See Steven J. Gluckman*, Exchange Act Rel. No. 41628, 1999 SEC LEXIS 1395, *22 (July 20, 1999) (citations omitted).

[33] NASD Conduct Rule 2310.

of trading in an account may also render transactions unsuitable.[34] "Excessive trading represents an unsuitable frequency of trading and violates NASD suitability standards."[35]

In considering the churning charge, the Hearing Panel found that Respondent controlled GM's account, because he exercised discretion for three months (and beyond) and directed trading in the account. Based on the turnover rate, commission-to-equity and cost-to-equity ratios, the Panel also found that Respondent engaged in excessive trading in the account that conflicted with his customer's financial needs and investment objectives.[36]

Even if the Panel were to credit Respondent's testimony that GM desired and approved of the aggressive approach Respondent recommended, it was Respondent's obligation to determine the type and amount of trading suitable for his customer. Without question, it is a broker's "duty to refrain from making recommendations that are incompatible with the customer's financial situation and needs," regardless of the customer's desire to engage in speculative or aggressive trading.[37]

Here, Respondent did not perform an analysis of GM's financial situation or needs or consider his investment experience or objectives. Though GM's previous account was invested in money market and mutual funds, Respondent never had any discussions with GM regarding his prior investment experience or lack thereof. Furthermore, GM was only willing to tolerate moderate risk. Nevertheless, Respondent allowed this customer to open a margin account and pursued an aggressive trading strategy that included tremendous use of margin and day trading.

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[34] *Paul C. Kettler*, Exchange Act Rel. No. 31354, 1992 SEC LEXIS 2750 (Oct. 26, 1992). *See also* IM-2310-2.

[35] *Kettler,* 1992 SEC LEXIS at *5.

[36] *See* pp. 10-13 *infra.*

[37] *Dep't of Enforcement v. Chase,* No. C8A990081, 2001 NASD Discip. LEXIS 30, at *17 (NAC Aug. 15, 2001) (other citations omitted).

Respondent continued to employ this strategy despite questions from his customer and mounting losses in the account. Respondent himself conceded that he engaged in trading that was not suitable for GM or for any of his customers.

By recommending and pursuing an aggressive strategy in a declining market for a customer who did not have the financial resources to withstand significant losses, Respondent breached his duty to recommend and pursue a course of trading that offered a degree of risk commensurate with his customer's financial situation and needs. The Hearing Panel thus finds that Respondent engaged in trading in GM's account that was unsuitable, due to the quantity of trades and excessive use of margin, in violation of NASD Conduct Rules 2310, 2110 and IM-2310-2, as charged in the second cause of the Complaint.[38]

3. Exercising Discretion Without Written Authority

NASD Conduct Rule 2510(b) prohibits a registered representative from exercising discretion in a customer's account without prior written authorization from both the customer and the firm. While GM gave Respondent written authority to trade his account, the firm did not approve the request. To the contrary, Compliance rejected the application for discretionary trading authority due to the level of trading activity and losses in the account.

Respondent concedes that he exercised discretion to trade GM's account from April to July 2001 and does not dispute the lack of written approval from the firm. Respondent's testimony that he believed Glenn's approval was sufficient to use discretion is unpersuasive. Respondent was required to know and follow the firm's procedures, which called for approval from the regional director and Compliance. Having recently received discretionary authority to trade other accounts at First Union, Respondent should have been well aware that three levels of

[38] A violation of an NASD rule also constitutes a violation of Conduct Rule 2110. *Gluckman*, 1999 SEC LEXIS 1395, at *22.

approval were required.[39] Respondent's testimony is further undermined by account questionnaires he completed in August 2001 and June 2002, in which he denied ever having used discretion in GM's account.[40]

Finally, the Panel rejects Respondent's testimony that, once Compliance rejected discretion, he phoned GM before each trade. The sheer volume of trading renders it difficult to credit this testimony. Moreover, Respondent admitted he never told GM that the firm rejected his application for discretion. The Panel thus believes that Respondent exercised discretion in GM's account throughout the period at issue.

Accordingly, the Hearing Panel finds that Respondent exercised discretionary power in GM's account without written authority from his member firm, in violation of NASD Conduct Rules 2510(b) and 2110, as charged in the third cause of the Complaint.

III. Sanctions

Enforcement alleges that Respondent's conduct is egregious and seeks imposition of a bar.[41] Respondent suggests that at most the Panel should impose a fine in accordance with NASD guidelines.[42] In determining appropriate sanctions, the Hearing Panel considered NASD's Sanction Guidelines (Guidelines) for each violation, as well as the Guidelines' General

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[39] Forms from two of Respondent's discretionary accounts (Customer GW, who applied in September 2000, and customers R and JW, who applied in November 2000) show signatures from Respondent's branch manager, retail manager and Compliance. In GW's case, there was a five-month delay between the branch manager's approval and approval by Compliance; in R and JW's case, there was a two-month delay. Even if Respondent did not see the forms after all three signatures were obtained, he nonetheless saw the blank spaces for those signatures when he completed the form. In addition, the firm's procedures were clear and unambiguous regarding the need for three levels of approval. (Tr. 392-95; CX-5, CX-13.)

[40] Tr. 360, 362-63, 400; CX-11, CX-12.

[41] Tr. 464-65. Enforcement is not seeking a fine, in light of its request for a bar, nor restitution, because the customer has been made whole. (*See* Enforcement's Pre-Hearing Brief at 11, n.18.)

[42] Tr. 437.

Principles Applicable to All Sanction Determinations and Principal Considerations in Determining Sanctions.[43]

A. Churning and Unsuitability

The Guideline for churning or excessive trading recommends a fine of $5,000 to $75,000, plus the amount of financial gain; in addition, a suspension in any or all capacities for ten business days to one year is recommended. In egregious cases, a longer suspension or a bar is recommended.[44] The Guideline for unsuitable recommendations is virtually the same. The only distinction is that the recommended fine amount is $2,500 to $75,000 for unsuitability.[45]

The Guidelines list no specific factors for adjudicators to consider when imposing sanctions for churning, excessive trading or unsuitable recommendations, but the Hearing Panel finds that Respondent's misconduct was egregious based on the pattern of trading in GM's account. Respondent intentionally or recklessly churned his customer's account over an extended period and engaged in a pattern of unsuitably frequent trading at his customer's expense, even in the face of mounting losses. He executed more than 500 trades in little more than a year and generated more than $30,000 in commissions for himself. The turnover rate in the account was more than five times what is considered evidence of excessive trading.

There are additional aggravating factors that support imposition of a bar. Respondent's actions demonstrated his willingness to ignore his responsibilities to his customer and resulted in economic injury to GM. Respondent took advantage of an unsophisticated investor who placed his trust in him and abused the discretionary authority he was given. Respondent profited from his misconduct, and until the hearing, took no responsibility for his actions.

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[43] *Guidelines* at 2-7 (2006 ed.).

[44] *Id*. at 82.

[45] *Id.* at 99.

The Hearing Panel finds no mitigating factors or circumstances in this case and takes no comfort in the fact that Respondent is subject to special supervision at his current firm. Respondent was previously subject to special supervision for mishandling a discretionary account, and yet, it was only a matter of months after the heightened scrutiny ended before he engaged in similar misconduct by seeking and abusing discretion in GM's account. Though Respondent admirably expressed regret at the hearing for having harmed his customer, he failed to take responsibility for his misconduct until long after disciplinary charges were filed.

In light of the foregoing, the Panel concludes that any association with a member firm would create an unacceptable risk of future violations of the securities laws and NASD Rules. Accordingly, Respondent is barred from association with any member firm in any capacity for churning GM's account, as charged in the Complaint. Because the churning and unsuitability charges involve the same transactions, a bar is imposed for each cause of action.[46]

B. Exercising Discretion Without Written Authority

The Guideline for exercising discretion without a customer's written authority recommends a fine of $2,500 to $10,000, plus the amount of respondent's financial benefit from the transactions, and, in egregious cases, a suspension of 10 to 30 business days.[47] The Guideline lists as principal considerations in determining sanctions: (1) whether the customer's grant of discretion was express or implied, and (2) whether the firm's policies and/or procedures prohibited discretionary trading and/or whether the firm prohibited respondent from exercising discretion in customer accounts. The Guideline does not address the situation at hand, where a respondent had the customer's, but not the firm's, written authority to use discretion.

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[46] When a bar is imposed, the Panel may exercise its discretion and refrain from imposing a fine. *Guidelines* at 10 (Technical Matters: Monetary Sanctions).

[47] *Id.* at 90.

The Hearing Panel finds that Respondent's misconduct was serious. Though he had the customer's written authority to exercise discretion, he failed to wait for final approval before exercising discretion and pursuing an extremely aggressive and risky strategy. Moreover, the Panel believes that Respondent continued to exercise discretion in the account notwithstanding the rejection by Compliance.

In our view, Respondent's misconduct would merit a fine and suspension in the upper range of recommended sanctions; however, in light of the bars, a suspension and fine would be redundant and would serve no remedial purpose.[48] Accordingly, no further sanctions are imposed for Respondent's exercise of discretionary power in a customer's account without the firm's written approval.

IV. Conclusion

Respondent Brian J. Kelly is barred from association with any member firm in any capacity for churning a customer's account, in violation of Section 10(b) of the Securities Exchange Act and Rule 10b-5 promulgated thereunder, NASD Conduct Rules 2120 and 2110, and for recommending unsuitable transactions in the customer's account, in violation of NASD Conduct Rules 2310, 2110 and IM-2310-2. In light of the bars, no additional sanctions are imposed for exercising discretionary power in the customer's account without the firm's written approval, in violation of NASD Conduct Rules 2510(b) and 2110. In addition, Respondent shall pay costs in the amount of $2,794.81, which includes an administrative fee of $750 and hearing transcript costs of $2,044.81.[49]

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[48] *See, e.g.*, *Castle Securities Corp.*, 2004 NASD Discip. LEXIS 1, at *36-37; *Dep't of Enforcement v. Hodde*, No. C10010005, 2002 NASD Discip. LEXIS 4, at *17 (NAC Mar. 27, 2002).

[49] The Hearing Panel has considered all of the arguments of the parties. They are sustained or rejected to the extent they are in accord or inconsistent with the views expressed herein.

The bars shall become effective immediately, should this Decision become NASD's final disciplinary action in this matter.

SO ORDERED.

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Dana R. Pisanelli
Hearing Officer
For the Hearing Panel

Dated: July 12, 2007
Washington, DC

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