FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant v. KALE E. EVANS (CRD No. 2236466), Respondent.	Disciplinary Proceeding No. 2006005977901 Hearing Officer – MC **HEARING PANEL DECISION** October 16, 2009

Respondent Kale E. Evans is barred from associating with any FINRA member firm in any capacity for: (i) recommending and effecting unsuitable transactions in a customer's account, in violation of Conduct Rules 2110 and 2310; (ii) making a payment to settle a customer complaint without the knowledge or authorization of his member firm employer, in violation of Conduct Rule 2110; and (iii) engaging in an unethical business-related course of conduct, in violation of Conduct Rule 2110.

Appearances

Joel T. Kornfeld, Senior Regional Counsel, Los Angeles, CA, for the Department of Enforcement.

Respondent Kale E. Evans, San Diego, CA, pro se.

DECISION

I. Introduction and Procedural History

The Complaint filed in this disciplinary proceeding arises from the management of the proceeds of a life insurance policy by Respondent Kale E. Evans ("Evans") on behalf of AV, the daughter of a close friend of Evans who died unexpectedly.

On March 18, 2004, AV's father, JV, died in a motorcycle accident. AV, then 17 years old, was JV's eldest child. Shortly after the accident, AV and her three younger siblings moved temporarily into the home of Evans and his family with the consent of

their mother and grandmother, even though Evans was not a relative and not the legal guardian of the children. At the time, Evans was registered with FINRA member firm TD Waterhouse Investor Services, Inc. ("Waterhouse" or the "Firm") as a General Securities Representative. After AV received the proceeds of her father's life insurance policy, she consented to Evans' proposal to deposit $400,000 of her money into an account at Waterhouse. AV believed the money would be placed in a "savings account" that would earn a higher rate of return than it was getting in her bank account.

A. The Complaint and Answer

The Department of Enforcement ("Enforcement") served and filed the four-count Complaint on March 10, 2009. The first two Causes of Action both allege that Evans violated the suitability requirements imposed by Conduct Rule 2310.[1] Generally, to meet suitability requirements, a broker's recommendation for the purchase or sale of a security must be founded on a reasonable basis for believing that the recommendation is in the best interests of the customer to whom it is made, based upon the customer's financial situation and investment objectives.[2] Determination of whether a broker has met this suitability obligation focuses on the quality of the security and the circumstances of the customer. Another prong of suitability requires that the number of transactions executed by a broker on behalf of a customer be suitable, and not excessive, in light of the

[1] As of July 30, 2007, NASD consolidated with the member regulation and enforcement functions of NYSE Regulation and began operating under a new corporate name, the Financial Industry Regulatory Authority (FINRA). References in this decision to FINRA include, where appropriate, NASD. Following consolidation, FINRA began developing a new FINRA Consolidated Rulebook. The first phase of the new consolidated rules became effective on December 15, 2008, including certain conduct rules and procedural rules. *See* Regulatory Notice 08-57 (Oct. 2008). This decision refers to and relies on the NASD Conduct Rules that were in effect at the time of Respondent's alleged misconduct. The applicable rules are available at www.finra.org/rules.

[2] *Dane S. Faber*, Exch. Act Rel. No. 58737, 2008 SEC LEXIS 2459, at *23-24 (Feb. 10, 2004), *cited in Dep't of Enforcement v. Medeck*, No. E9B2003033701, 2009 FINRA Discip. LEXIS 7, at *31 n. 9 (NAC July 30, 2009).

customer's financial circumstances and investment objectives.[3] Determination of whether a broker has met this type of suitability obligation focuses on a quantitative analysis of the trading done on behalf of a customer.

The Complaint alleges both forms of unsuitability. The First Cause of Action of the Complaint alleges that the transactions recommended and effected by Evans in AV's account were qualitatively unsuitable for AV, in violation of Conduct Rules 2110 and 2310. The Second Cause of Action alleges that Evans engaged in quantitatively unsuitable trading by effecting an excessive number of transactions without a reasonable basis for believing the volume of trading was suitable for AV, in violation of Conduct Rules 2110, 2310, and IM-2310-2.[4] Because both causes of action involve violations of the suitability rule and arise from the same transactions, the Hearing Panel addresses the First and Second Causes of Action together.

The Third Cause of Action alleges that after AV complained to Evans about the losses he caused in her account, he paid her $35,000 to settle her complaint, without the knowledge or consent of his member firm employer, in violation of Conduct Rule 2110.

Finally, the Fourth Cause of Action alleges that by the misconduct described in the first three Causes of Action, and by misappropriating funds from AV, Evans also

[3] Medeck, supra at *32.

[4] The Complaint also alleges that Evans violated Conduct Rule 2510(a). Conduct Rule 2510(a), located in a section of the Rules entitled Special Accounts, prohibits excessive trading by a broker vested with discretionary authority over an account. IM-2310-2, entitled Fair Dealing with Customers, focuses on excessive trading or churning. Under the circumstances of this case, and because there is no evidence that Evans possessed written or oral discretionary authority to trade on AV's behalf, the Hearing Panel finds it unnecessary to engage in an analysis of the applicability of Conduct Rule 2510(a) to Evans' conduct. As explained below, the Hearing Panel is satisfied that the trades executed by Evans in AV's account met the elements required to establish violations of the suitability requirements imposed by Conduct Rule 2310 in terms of both the quality of the securities purchased and sold and the number of trades executed in the relevant period.

violated the high standards of commercial honor and just and equitable principles of trade imposed by Conduct Rule 2110.

Evans filed an Answer on April 24, 2009, stating as to each Cause of Action of the Complaint, "I admit this allegation and I waive a hearing on this matter."

B. Submissions in Lieu of a Hearing

At a pre-hearing conference held on May 15, 2009, the Hearing Officer, after summarizing the four Causes of Action, asked Evans directly if he still intended to admit the allegations in each of the four Causes of Action of the Complaint. Evans replied that he did. When asked if he also still wished to waive the hearing to which he was entitled, Evans reiterated his desire to do so.[5]

On May 15, 2009, the Hearing Officer issued a Scheduling Order directing the parties to file briefs and exhibits relating to the sanctions that should be imposed in this disciplinary proceeding. On June 19, 2009, Enforcement filed its Brief Regarding Sanctions, supported by the declaration of a FINRA examination manager and 31 exhibits. On June 22, 2009, Evans filed a preliminary brief and exhibits, and on June 29, 2009, he filed a revised brief and three exhibits, addressing the issue of sanctions.[6]

After giving due consideration to the submissions of the parties, including Evans' admissions to the allegations in his Answer, the Hearing Panel[7] reached the following

[5] Transcript of Pre-Hearing Conference, May 15, 2009, pp. 4-6.

[6] References to Enforcement's exhibits will be referred to as "CX-__," with the appropriate page or paragraph number. References to Enforcement's Brief Regarding Sanctions will be referred to as "Enforcement's Brief" with the appropriate page numbers. References to Evans' revised brief filed June 29, 2009, will be referred to as "Respondent's Brief," while references to Evans' exhibits will be referred to as "RX-__," with the appropriate page or paragraph number.

[7] The Hearing Panel consisted of two current members of the District 2 Committee and the Hearing Officer.

Findings of Fact and Conclusions of Law and deliberated on the question of sanctions. For the reasons given below, the Hearing Panel determined that in this case the only appropriate sanction for each of the violations alleged in the Complaint is a bar from association with any FINRA member firm in any capacity.

II. Findings of Fact and Conclusions of Law

A. The Respondent

Evans entered the securities industry as a General Securities Representative in June 1992. From June 1, 1998, until December 8, 2005, he was associated with Waterhouse.[8] On January 3, 2006, Waterhouse filed a Uniform Termination Notice for Securities Industry Registration ("Form U5"), reporting that Evans resigned voluntarily on December 8, 2005, for a "violation of firm policy."[9] Evans is currently associated with another FINRA member firm[10] and is therefore subject to FINRA's jurisdiction.

B. Factual Background

In March 2004, JV was divorced and had sole custody of the four children of the marriage.[11] At the time of the motorcycle accident, AV was 17 years old and was the eldest of the children.[12] A few days after JV died, AV and her three siblings moved into the Evans family home in San Diego, CA.[13] Evans did not have legal custody of the children, although he initiated guardianship proceedings in March or April 2004.[14]

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[8] CX-1.

[9] CX-15.

[10] CX-1.

[11] RX-2. AV's mother had remarried and lived in another area of California. *Id.* at pp. 1-2.

[12] Complaint, ¶¶ 6-8. AV turned 18 on August 1, 2004. AV has twin sisters, who were 13 years old, and a brother who was eight, at the time of their father's death. RX-1, p. 1.

[13] Complaint, ¶ 7; RX-2, p. 1.

[14] CX-2, p. 13, at sub-page 48.

Before the process was complete, their mother decided she wished to have custody of her children, and AV's two sisters and brother left the Evans household to join their mother in October or November 2004.[15] AV, who was 18 years old by then, elected to remain with the Evans family until the summer of 2005.[16]

AV was the sole beneficiary of her father's life insurance policy, and she received its proceeds, totaling $514,000, in September and November 2004.[17] AV intended to use the funds to finance her own and her siblings' college educations.[18] She informed Evans, therefore, that she did not wish to invest the funds in the stock market because she did not want to expose them to risk; instead, she intended to maintain the funds in an interest-bearing savings account.[19]

AV deposited the life insurance proceeds in a savings account at Washington Mutual Bank ("WaMu") that Evans helped her open in April 2004 as a joint account with right of survivorship. Evans persuaded AV that it would be beneficial for him to be a signatory on the savings account and on her checking account at WaMu so that he could monitor the accounts, assist her in paying expenses, and ensure that she did not waste her money.[20] According to Evans, the purpose of the accounts was for him to help AV "take care of her affairs."[21] Although the WaMu accounts were joint accounts with right of

[15] CX-2, p. 19, at sub-page 71.

[16] *Id.*; CX-5, ¶ 6.

[17] Complaint, ¶¶ 6, 8.

[18] CX-5, ¶ 4.

[19] CX-3, ¶ 10, CX-5, ¶ 4; Complaint, ¶ 8.

[20] CX-5, ¶ 2.

[21] CX-2, p. 17, at sub-page 62.

survivorship,[22] the evidence is that AV intended, and Evans understood, that the money was to be used for the benefit of AV and her siblings. Indeed, Evans testified that if AV had predeceased him, he would have administered the funds consistent with her express wishes.[23]

In October 2004, Evans persuaded AV to allow him to open what she believed would be a savings account at Waterhouse, which he claimed would earn more interest for her than the WaMu savings account.[24] In his OTR on May 21, 2007, Evans testified that the purpose of the investment account was for him to "try to increase the assets" for AV.[25] Evans claimed that AV wanted the account to be "a joint account and that the trading basically would be handled by myself."[26] With her consent, Evans transferred $400,000 from AV's WaMu savings account into the account at Waterhouse.[27]

The account was a margin account; it named AV as the primary account holder and Evans as secondary joint account holder and joint tenant with right of survivorship.[28] The result was to give Evans complete control over the account. Because Evans' name

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[22] CX-7.

[23] In an on-the-record interview on May 21, 2007 ("OTR"), Evans stated that AV "wanted me to be on the account so that, if need be, I could help her … I could actually write checks, and if something were to happen to her, then the assets would come to me because I knew what she wanted to do with it." CX-2, p. 17, at sub-pages 62-63. Presumably, Evans' reference to "what she wanted" was based on his knowledge that AV's objective was to protect the funds so they could be used to finance her college education and the college educations of her two sisters and brother. CX-5, ¶ 4.

[24] *Id.*; Complaint, ¶ 9. In his OTR, Evans denied that he told AV her money was going to be put in a savings account with no risk of loss. CX-2, p. 36, at sub-page 138. He claimed that he discussed risk generally and the "general concepts of margin" with AV in connection with the account. *Id.*, p. 25, at sub-pages 95-96. Subsequently, however, in his Answer, Evans admitted the "allegation" in Cause Four of the Complaint, which specifically alleges that he told AV that the Waterhouse account into which he deposited her funds was a savings account with no risk of loss. Complaint, ¶ 42; Answer p. 2. This is consistent with AV's assertions. CX-5, ¶ 4.

[25] CX-2, p. 24, at sub-page 91; p. 35, at sub-pages 135-136.

[26] *Id.*, pp. 24-25, at sub-pages 93-94.

[27] Complaint, ¶ 10.

[28] CX-2, p. 24, at sub-page 91; CX-9.

was on the account as joint tenant, the Firm treated it as an "associate account" rather than a customer account.[29] Evans had previously learned that he could approve his own equity trades in an employee account, up to his "approval level," which was, according to him, "relatively high" because he was a supervisor authorized to approve large trades.[30] Consequently, Evans was free to trade in AV's Waterhouse account without oversight. From the end of October 2004 until March 10, 2005, Evans used AV's money to speculate, incurring large margin fees and losing more than 70% of the equity in the account.[31]

The new account documentation for the Waterhouse account contains no information about AV's assets, investment experience, investment objectives, or risk tolerance.[32] Evans testified that he filled out "the vast majority" of the application and did not recall the form requesting any such information about AV.[33] Evans knew, however, that AV was an unemployed student, had no experience with margin or with any brokerage account,[34] and that she had no money other than the proceeds of her

[29] CX-13.

[30] CX-2, p. 27, at sub-page 103. Evans did not recall the limit on his approval level, but conjectured that it was 10,000 shares. At Waterhouse, Evans was an electronic broker service supervisor in the Firm's institutional equity trading department, responsible for maintaining the Firm's electronic trading platform but having no direct responsibility for customer accounts. CX-2, pp. 6-7, at sub-pages 20-24.

[31] Complaint, ¶¶ 2, 12; Schedule A to Complaint.

[32] CX-9.

[33] CX-2, p. 25, at sub-pages 96-97.

[34] CX-2, p. 25, at sub-pages 94-97. Evans testified at his OTR that he discussed with AV generally the risks and potential rewards of his plans for handling her money in the account, but did not provide her with specifics. *Id.* Evans also denied that he withheld the Waterhouse account statements from AV, and claimed she received them, although he did not review them with her and did not know if she looked at them. *Id.*, p. 29, at sub-pages 112-113; p. 36, at sub-pages 139-140. AV, however, has represented that while living with the Evans family, she did not personally receive or review Waterhouse account statements. CX-5, ¶ 6. According to her, mail to the Evans home was delivered to a locked mailbox to which AV did not have access. On one occasion, AV happened across an account statement in the house that appeared to show a negative balance in her account and when she queried Evans about it, he told her it was an old statement, said that he had taken care of the problem, and advised her that there was nothing to worry about. *Id.*

father's life insurance policy.[35]

During this period, Evans transferred other monies totaling approximately $127,000 from AV's WaMu account[36] into accounts he held jointly with his wife, and used a portion to pay their personal debts.[37]

In November 2005, several months after she moved out of the Evans home, AV asked Evans to transfer her funds from the Waterhouse account back into her WaMu savings account.[38] Evans returned only $109,000 of the $400,000 that had been deposited into the Waterhouse account. Upon realizing this, AV demanded an explanation for the missing funds and documentation to account for the money.[39] When Evans and AV met to discuss the matter in November 2005, Evans cried, apologized, told AV that she was owed approximately $60,000, and disclosed that he could not provide an accounting of her funds because he had not brought receipts and had not kept track of what he had done with her money.[40] Evans gave AV a check in the amount of $35,000.[41] AV told Evans this was insufficient and that she wanted the entire $400,000 returned to her.[42] AV then requested Waterhouse to provide her with copies of statements for her account and an explanation of what had happened.[43]

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[35] CX-2, p. 25, at sub-page 95.

[36] Complaint, ¶ 42.

[37] *Id.*, ¶¶ 16-26.

[38] CX-5, ¶ 7.

[39] *Id.*, ¶ 8.

[40] *Id.*, ¶ 9.

[41] CX-5, ¶ 9; Complaint, ¶ 28. AV stated the check was for $32,000, but the actual amount was $35,000. *See* CX-12.

[42] CX-5, ¶ 9.

[43] Complaint, ¶ 29; CX-5, ¶ 10.

C. First and Second Causes of Action: Evans Recommended and Effected Trades that Were Qualitatively and Quantitatively Unsuitable, in Violation of Conduct Rules 2110, 2310 and IM-2310-2

Between October 28, 2004, and March 10, 2005, Evans exercised sole control over the Waterhouse account, determining what securities to buy and sell, and when to execute trades.[44] In that time, Evans caused the account to lose more than 70% of its value, diminishing it from $400,000 to $109,653.27.[45] When he was asked why he thought the speculative trades he effected were appropriate for AV, Evans did not provide a responsive answer but instead claimed he was thinking in terms of "day trading and things of that nature," although admittedly he had no previous day trading experience.[46]

Evans' initial transaction was an uncovered short sale of 1,000 shares of Google, Inc.[47] He admitted that his subsequent trades in Google stock were "speculative" and "aggressive," and when he was asked why he felt they were suitable for AV, he answered "I don't know."[48]

Evans' admittedly aggressive, speculative trading was characterized by concentrated positions in a few securities, large margin interest balances, and short holding periods.[49] For example, at the end of January 2005, AV's Waterhouse account was concentrated in a single equity position in the stock of Research In Motion, Ltd. ("RIMM") and the margin debit balance was $271,536.[50] During his OTR, Evans was asked to explain his purchases of RIMM. In reply, Evans said that he "bought a pretty

[44] Complaint, ¶¶ 11-12; Schedule A to Complaint.

[45] Complaint, ¶¶ 11, 12, 15; CX-2, p. 31, at sub-page 120.

[46] CX-2, p. 28, at sub-pages 106-107.

[47] Complaint, ¶ 13; CX-31, p. 3.

[48] CX-2, p. 27, at sub-page 104.

[49] CX-31.

[50] CX-11, p. 42.

heavy position" and the "[m]arket went against me, and then they halted trading on it, and when they commenced trading on it, there was a significant difference in the price."[51] When asked whether he considered what measures to take in the event he lost money in AV's account, Evans said, simply, "No."[52]

In the nearly five-month period during which Evans actively speculated with the funds in the Waterhouse account, he effected 80 transactions on behalf of AV.[53] As Enforcement alleges, and the Hearing Panel finds, there was no reasonable basis for Evans to believe that the volume of trading in which he engaged in the account was suitable for AV, considering her financial circumstances and her objectives.[54]

Repeatedly purchasing stocks, holding them briefly, and then selling them, constitutes "in-and-out trading," a practice that is difficult to justify and that can provide a basis for a finding of unsuitably excessive trading.[55] In the Waterhouse account, Evans engaged in such trading. For example, over approximately three weeks in December 2004, Evans executed the following transactions involving shares of Travelzoo Inc. ("TZOO"), resulting in a loss of $36,927:

- On December 7, Evans purchased and then sold 15,000 shares of TZOO.
- On December 8, Evans purchased 7,000 shares of TZOO.
- On December 10, Evans sold 2,000 shares of TZOO.
- On December 21, Evans sold 4,100 shares of TZOO.
- On December 30, Evans purchased 3,000 shares, and sold 3,900 shares, of TZOO.
- On December 31, Evans bought and sold 2,000 shares of TZOO.[56]

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[51] CX-2, p. 28, at sub-page 109.

[52] Id.

[53] Complaint, ¶ 12; Schedule A to Complaint.

[54] Complaint, ¶ 36.

[55] *Costello v. Oppenheim*, 711 F.2d 1361, 1369 n. 9 (7th Cir. 1983); *Dep't of Enforcement v. O'Hare*, No. C9B030045, 2005 NASD Discip. LEXIS 39 at *14-15 (NAC Apr. 21, 2005); *Harry Gliksman*, *supra*, at *12-13.

[56] Complaint, ¶ 14.

The Waterhouse account records show similar in-and-out trading patterns in other securities in which Evans speculated in the account.[57]

1. Qualitative Unsuitability

Conduct Rule 2310 requires a registered representative, when recommending and effecting securities transactions on behalf of a customer, to do so based upon reasonable grounds to believe the recommendations are suitable for the customer, considering the customer's financial situation and needs. This obligation flows from the requirement that a broker act in the best interests of the client.[58]

In this case, by his own admission, Evans effected his speculative trades on AV's behalf without consulting with her about the transactions.[59] During the nearly five months that the Waterhouse account was active, AV was unaware of Evans' speculation with the proceeds of her father's life insurance policy. Thus, she did not authorize the transactions Evans effected in her account. She trusted, incorrectly, that the funds were safely earning interest in the savings account into which Evans had told her he deposited them.[60]

The fact that he did not formally recommend the transactions to AV before effecting trades did not relieve Evans from his responsibility to ensure that the trades he engaged in were suitable for AV. This is because of the well-established rule that when a

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[57] CX-31, Schedules B and E.

[58] *Dep't of Enforcement v. Dunbar*, No. CO7050050, 2008 FINRA Discip. LEXIS 18 (NAC May 20, 2008).

[59] In his OTR, Evans was asked: "And did you have any discussions with [AV] with respect to how this account would be handled? In other words, what it would be invested in, that sort of thing?" He answered: "Not specific like we're going to buy AT&T; so not specifically." CX-2, p. 25, at sub-page 94. The Complaint alleges that AV was unaware of the activity in her account. Complaint, ¶ 11.

[60] CX-5, ¶¶ 5-6.

broker executes transactions on behalf of a client that are not specifically authorized, the broker is considered to have implicitly recommended the transactions to the client. [61]

On the record of this case, there is no question that Evans' implied recommendations[62] and speculative trading were qualitatively unsuitable for AV. Evans admitted that he did not even consider whether the trades he executed in the Waterhouse account were suitable for AV's financial circumstances and objectives.[63]

The Hearing Panel finds that by effecting the speculative trades described above in the Waterhouse account, Evans made unsuitable recommendations to AV, as alleged in the First Cause of Action of the Complaint, and as admitted by Evans. Evans lacked reasonable grounds to believe that the speculative trades he executed were suitable for AV, in light of her age, lack of investment experience, financial circumstances and objectives, and her express directive that her money not be exposed to risk. Given AV's objective of protecting the proceeds of her father's life insurance from risk, and preserving the inheritance for the future education of her siblings and herself, the Hearing Panel finds, as Evans admits, that his speculative trading on AV's behalf was qualitatively unsuitable, in violation of Conduct Rules 2110 and 2310, as alleged in the First Cause of the Complaint.

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[61] When he executes unauthorized securities trades, a registered representative implicitly recommends the trades within the meaning of the Rules. *Paul C. Kettler,* Exch. Act Rel. No. 31354, 1992 SEC LEXIS 2750 (Oct. 26, 1992).

[62] "Transactions that were not specifically authorized by a client but were executed on the client's behalf are considered to have been implicitly recommended within the meaning of the NASD rules." *Rafael Pinchas,* Exch. Act Rel. No. 41816, 54 S.E.C. 331, 341 n. 22 (1999), 1999 SEC LEXIS 1754 (Sept. 1, 1999), *cited in Medeck, supra* at *35; *Dep't of Enforcement v. Dunbar, supra* at *21, n. 15 (NAC May 20, 2008); *Dep't of Enforcement v. Haq*, No. ELI2004026701, 2009 FINRA Discip. LEXIS 3 at *21, n. 15 (NAC Apr. 6, 2009).

[63] CX-2, p. 35, at sub-pages 135-136.

2. Quantitative Unsuitability

Evans' trading was also quantitatively unsuitable, as charged in the Second Cause of the Complaint. The Securities and Exchange Commission has held that "excessive trading, by itself, can violate [FINRA] suitability standards by representing an unsuitable frequency of trading."[64] A registered representative engages in excessive trading when he (i) exercises control over trading in an account and, (ii) engages in a volume of trading that is unsuitably excessive in light of the investment objectives and financial situation of the account owner.[65]

Evidence of control exists when the broker initiates all of the transactions in question.[66] Elements to consider in determining control include the customer's age, education, investment experience, and relationship with the broker.[67] By these measures, as noted above, Evans controlled the Waterhouse investment account into which he had placed $400,000 of AV's funds. To recapitulate, Evans alone entered all of the trades in the account.[68] AV was only 18 years old and preparing to attend a junior college. Evans knew she had no experience with investments and brokerage accounts.[69] Further, Evans' relationship with AV placed him in a particularly sensitive role of trust, in light of her circumstances, based partly on his experience in the securities industry and partly on his personal relationship with AV's deceased father.

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[64] *Pinchas, supra,* 54 S.E.C. 331, 342.

[65] Dep't of Enforcement v. Haq, supra at *22, citing Pinchas, supra at 54 S.E.C. 331, 337.

[66] *Harry Gliksman,* 54 S.E.C. 471, 475, 1999 SEC LEXIS 2685, at *6-7 (1999).

[67] *Zaretsky v. E.F. Hutton & Co.*, 509 F. Supp. 68, 74 (S.D.N.Y. 1981).

[68] Complaint, ¶ 11; CX-2, p. 27, at sub-page 102.

[69] Complaint, ¶ 9; CX-2, p. 25, at sub-page 94.

As Enforcement argues, and as he admits by his Answer, Evans engaged in an unsuitably excessive volume of trading on AV's behalf, in light of her investment objectives and financial situation. Evans' trading was excessive by the accepted standards of measurement, including the number – 80 transactions in less than five months – and frequency of trades, the turnover rate, and the pattern of "in-and-out trading,"[70] as described above.

Turnover is a measure of the number of times in a given period that a security in an account is sold and replaced with another.[71] The turnover rate is calculated using a formula (the "Looper formula")[72] by dividing the total cost of purchases made during a given period by the average amount invested monthly. Generally, an annual turnover rate of six or more creates a presumption of excessive trading.[73] The annualized turnover rate in the Waterhouse account in the period during which Evans controlled it was approximately 121.[74]

Based upon these uncontested facts, the Hearing Panel concludes that Evans' trading in the Waterhouse account on AV's behalf was also quantitatively unsuitable, in

[70] Harry Gliksman, supra, 477-478; John M. Reynolds, supra at 808 n. 12 (1991); Dep't of Enforcement v. O'Hare, supra at *15 (NAC Apr. 21, 2005).

[71] *Dep't of Enforcement v. Dunbar, supra* at *23 (NAC May 20, 2008), quoting *J. Stephen Stout,* 54 S.E.C. 888, 910 n. 50 (2000).

[72] The name of the formula comes from the case of *Looper & Co.,* 38 S.E.C. 294 (1958).

[73] *David Wong,* Exch. Act Rel. No. 45,426, 2002 SEC LEXIS 339, at *14 (Feb. 8, 2002).

[74] Complaint, ¶ 35.

violation of Conduct Rules 2110, 2310, and IM-2310-2, as alleged in the Second Cause of Action of the Complaint.[75]

D. Third Cause of Action: Evans Paid a Settlement Without the Knowledge or Authorization of His Employer Firm, in Violation of Conduct Rule 2110

A registered representative who settles a customer complaint or loss without the knowledge or authorization of his employer firm violates Conduct Rule 2110.[76]

In November 2005, after discovering that Evans had returned only a fraction of her funds to her WaMu account, AV met with Evans and demanded an explanation.[77] At the meeting, Evans gave AV a check in the amount of $35,000.[78] According to AV, Evans apologized and offered the check as partial payment of what he said she was owed.[79] In his OTR, Evans denied that the check represented "a reimbursement of funds or a payback" and claimed that he offered it because he "just felt bad about the situation."[80] Subsequently, however, in his Answer to the Complaint, Evans admitted the allegation that the payment was an unauthorized settlement. Thus, the Hearing Panel finds that Evans gave AV the check, without the knowledge or consent of Waterhouse, to

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[75] As noted above, the Second Cause of Action of the Complaint also alleges that Evans' excessive trading violated Conduct Rule 2510(a), which applies if a broker exercises discretionary authority over a customer's account. In Enforcement's Brief, Enforcement discusses the distinction between express and *de facto* control, to establish that Evans, by making himself a joint tenant of AV's Waterhouse investment account, placed himself in a situation of controlling the account and exercising full discretion in making investment decisions, without having obtained formal discretionary authority from AV. In light of the undisputed fact that Evans controlled AV's funds in the account, the Hearing Panel finds it unnecessary to reach the question of the applicability of Conduct Rule 2510(a) to the facts of this case, since it is sufficient for the purposes of establishing Evans' liability, which he concedes, that he controlled the account and engaged in unsuitably excessive trading, in violation of the suitability requirements imposed by Conduct Rules 2110, 2310 and IM-2310-2.

[76] *Dep't of Enforcement v. Paratore*, No. 200002570601, 2008 FINRA Discip. LEXIS 1, 9 (NAC Mar. 7, 2008).

[77] CX-5, ¶¶ 8, 9.

[78] CX-12.

[79] CX-5, ¶ 9.

[80] CX-2, p. 33, at sub-page 127.

settle her complaint about his trading in the Waterhouse account, as alleged in the Third Cause of Action of the Complaint.[81] Based upon these findings of fact, the Hearing Panel concludes that Evans violated Conduct Rule 2110.

E. Fourth Cause of Action: Evans Failed to Observe High Standards of Commercial Honor and Just and Equitable Principles of Trade, in Violation of Conduct Rule 2110

Conduct Rule 2110 requires registered representatives, in all their business-related conduct, to conform their conduct to "high standards of commercial honor and just and equitable principles of trade."[82] In the Fourth Cause of Action of the Complaint, Enforcement alleges that by the misconduct described in the First, Second and Third Causes of Action, and by Evans' misappropriation of funds belonging to AV in addition to those in the Waterhouse account, Evans failed to meet this fundamental standard required of him.

First, Evans acted unethically when he persuaded AV, who was young, an inexperienced investor, and whose father had recently and unexpectedly died, to allow him to transfer $400,000 to a Waterhouse margin account, intending to speculate with the funds, when he knew AV wanted the money safely deposited in a savings account.[83]

Second, Evans acted improperly when he opened the Waterhouse account with himself as a joint tenant, causing Waterhouse to view it as an employee account and therefore one that was not subject to the same level of supervisory review that it would have received under normal circumstances as a typical customer account.[84]

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[81] Complaint, ¶¶ 38-39.

[82] *Dep't of Enforcement v. Shvarts*, No. CAF980029, 2000 NASD Discip. LEXIS 6, *11-12 (NAC June 2, 2000).

[83] Complaint, ¶ 42.

[84] *Id*.

Third, Evans misappropriated AV's funds when he transferred monies from her WaMu savings account and used them for his own purposes. These monies included $60,000 he transferred to his personal brokerage accounts, $32,450 he deposited to personal bank accounts held jointly with his wife, and $35,000 he used to pay off creditors.[85]

The Hearing Panel finds that by engaging in this course of conduct in connection with his management of AV's funds, Evans violated Conduct Rule 2110, as alleged in the Fourth Cause of Action of the Complaint, and admitted by Evans.

III. Sanctions

For making unsuitable recommendations in violation of Conduct Rules 2110 and 2310, FINRA's Sanction Guidelines recommend a fine of $2,500 to $75,000, suspension in any or all capacities from ten business days to one year and, in egregious cases, a suspension of up to two years or a bar.[86] For settling customer complaints away from one's firm in violation of Conduct Rule 2110, the Guidelines recommend a fine of $2,500 to $50,000, a suspension in any or all capacities for up to two years, and in egregious cases, a bar.[87] For unethical conduct in violation of Conduct Rule 2110, the Guidelines contain no specific recommended sanctions. For misappropriating, or converting, customer funds, the Guidelines recommend a bar.[88]

[85] Complaint, ¶ 42.

[86] FINRA Sanction Guidelines, p. 99 (2007).

[87] Sanction Guidelines, supra at 36.

[88] *Id.*, p. 38.

Enforcement, characterizing Evans' conduct as egregious, recommends imposition of a bar for Evans' violations described in each Cause of Action of the Complaint.[89]

Evans, however, requests "probation" for one year, and to be allowed during that year to be "associated with a FINRA related firm in order to provide financially for his family."[90] In his Brief, Evans lists factors he believes should mitigate the sanctions imposed in this case. He notes that after JV's fatal accident, AV and her siblings moved into the Evans home and he assumed responsibility for their care. Evans asserts that he assisted AV with tasks related to attending to her father's estate. Evans claims he paid numerous bills, including mortgage payments on JV's house and costs associated with readying the house for rental. Evans argues that he supported AV and her siblings for a number of months and applied to obtain guardianship status over AV's two sisters and brother.[91] Evans represents that he included AV and her siblings in a vacation to the Fiji Islands that he had previously planned for his own family.[92]

The Hearing Panel notes that Evans provided assistance to AV and her siblings after their father's death. The Hearing Panel accepts Evans' representations that at a difficult time for them, at least initially, he "did the very best job that he could" to assist

[89] Enforcement makes no recommendation for restitution. In light of the payments made by Evans that returned a portion of her money to AV, combined with the settlement of the arbitration claim filed by AV, the Hearing Panel finds that AV has been made whole and there is no need for an Order of Restitution in this case.

[90] Respondent's Brief, p. 5.

[91] Respondent's Brief, ¶¶ 2-4. According to Evans, in August 2004, JV's former wife intervened and took custody of the children, with the exception of AV, who, because she had just turned 18, was able to choose to remain with the Evans family, where she stayed until the summer of 2005. *Id.*, ¶ 7; CX-5, ¶ 6.

[92] *Id.*, ¶ 5.

JV's children.[93] The Hearing Panel finds, however, that even if the factors Evans presents could properly be deemed mitigating, they pale in contrast to the egregiousness of Evans' conduct.

Furthermore, the Hearing Panel does not credit additional explanations proffered by Evans for consideration as mitigation in connection with sanctions. For example, Evans seems to suggest that he had a right to speculate with AV's funds in the Waterhouse account because he was a joint tenant on the account and therefore he felt he "was acting in the capacity of a personal owner relationship verses [sic] a fiduciary capacity advisor or broker" on the Waterhouse account.[94] This contention ignores the fact that AV was a teenager suffering from the loss of her father, and that she relied on Evans for guidance in her effort to preserve the proceeds of her father's life insurance policy for herself and her siblings for educational purposes. In addition, Evans' assertion that he could rightfully consider himself as an owner of the account conflicts with the fact that he has consistently conceded that the funds belonged to AV, not to him, and he understood her intentions for their use. Nowhere in the record of this proceeding does he claim otherwise.

Evans further asserts that "Aside from the financial situation of AV all of the … kids left [the] house better mentally, emotionally, and physically."[95] This unsupported assertion, even if true, totally disregards the enormous importance of the "financial situation of AV" to her and her siblings. The assistance Evans offered to JV's surviving children after their family tragedy cannot mitigate his irresponsible mishandling of their

[93] *Id.*, ¶ 19.

[94] Respondent's Brief, ¶ 13.

[95] *Id.*, ¶ 19.

"financial situation" and the stark reality that he abused his relationship with AV and abrogated the responsibility entailed when he took charge of her father's life insurance proceeds.

Evans' representation that he should not be barred because "AV was made financially whole with the outcome of the civil suit"[96] is disingenuous at best and reflects a failure on his part to appreciate the seriousness of his misconduct and to accept full responsibility for his actions. While it is true that AV was eventually successful in her effort to recover the monies dissipated by Evans, she had to file suit against Evans and Waterhouse in a California court to do so[97] It was not until February 26, 2007, after Waterhouse filed a motion to compel arbitration and AV filed an arbitration claim[98] that AV succeeded in obtaining a settlement in which Waterhouse paid her $360,000 and Evans paid her $40,000.[99] From November 2005 until the settlement, AV lived with the realization that Evans, a trusted former friend of their father, had squandered over 70 percent of the proceeds of her father's life insurance policy, the inheritance that AV planned to use for her and her younger siblings' college educations.

The Hearing Panel finds that there are other aggravating factors present in this case that are identified in the Sanction Guidelines' Principal Considerations in Determining Sanctions. Evans' misconduct occurred over a period of five months with the commission of numerous individual acts that constituted an egregious pattern of misconduct.[100] By establishing himself as a joint tenant in AV's Waterhouse account,

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[96] Respondent's Brief, ¶ 21.

[97] CX-5.

[98] CX-3.

[99] CX-19, pp. 1-2.

[100] Principal Considerations Nos. 8 and 9, *Sanction Guidelines, supra* at pp. 6-7.

Evans was able to conceal his misconduct from possible supervisory review and discovery by his Firm.[101] Evans' reckless trading in the account was the result of a series of willful, intentional acts.[102] The number of transactions and their size are also aggravating factors.[103]

For all of these reasons, the Hearing Panel finds that Evans' misconduct, as described in each Cause of Action of the Complaint, was so egregious that only a bar will suffice to protect the investing public by deterring Evans from further similar misconduct, and to serve as a deterrent to others.

IV. Order

Respondent Kale E. Evans is barred from associating in any capacity with any FINRA member firm for each of the violations alleged in the Complaint: (i) recommending and effecting unsuitable transactions in a customer's account, in violation of Conduct Rules 2110 and 2310; (ii) making a payment to settle a customer complaint without the knowledge or authorization of his member firm employer, in violation of Conduct Rule 2110; and (iii) failing to observe high standards of commercial honor and just and equitable principles of trade, by engaging in an unethical business-related course of conduct, in violation of Conduct Rule 2110.

[101] Principal Consideration No. 10, *Id.*

[102] Principal Consideration No. 13, *Id.*

[103] Principal Consideration No. 18, *Id.*

If this Decision becomes FINRA's final disciplinary action, the bars shall be effective immediately. In addition, Evans is ordered to pay the costs of this proceeding, consisting of an administrative fee of $750.[104]

HEARING PANEL.

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By: Matthew Campbell
Hearing Officer

Copies to:

Kale E. Evans (via electronic, FedEx and first-class mail)
Joel T. Kornfeld, Esq. (via electronic and first-class mail)
Mark P. Dauer, Esq. (via electronic mail)
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[104] The Hearing Panel has considered and rejects without discussion all other arguments of the parties.