FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. STEPHEN W. WILSON (CRD No. 2235561), Respondent.	Disciplinary Proceeding No. 2007009403801 Hearing Officer – LBB **HEARING PANEL DECISION** April 14, 2010

For making fraudulent misrepresentations in violation of Section 10(b) of the Securities Exchange Act of 1934, SEC Rule 10b-5, and NASD Conduct Rules 2120 and 2110; recommending unsuitable mutual fund switch transactions in violation of NASD Conduct Rules 2310 and 2110, and IM-2310-2; engaging in unauthorized trading in violation of NASD Conduct Rule 2110 and IM-2310-2; engaging in discretionary trading without written authorization in violation of NASD Conduct Rules 2510(b) and 2110; and causing the books and records of his firm to be inaccurate in violation of NASD Conduct Rules 3110 and 2110, Respondent Stephen W. Wilson is barred in all capacities.

Appearances

For the Department of Enforcement: Gerard F. Murphy, Esq., Senior Counsel, and Jeff Kern, Esq., Senior Regional Counsel, New York, New York; and Robin W. Sardegna, Esq., Senior Litigation Counsel, Washington, D.C.

For Respondent: Peter Brown Dolan, Esq., Los Angeles, California.

DECISION

The Department of Enforcement filed the Complaint in this disciplinary proceeding on December 31, 2008. Enforcement filed an Amended Complaint on June 19, 2009. The Amended Complaint contains five causes of action against Respondent Stephen W. Wilson ("Respondent"): fraudulent misrepresentations and omissions; recommending and effecting unsuitable mutual fund switches; unauthorized trading; discretionary trading without written

authorization; and causing his firm's books and records to be inaccurate by submitting inaccurate reports.[1] Respondent answered the Complaint and the Amended Complaint, denying the allegations.

A six-day hearing was held in Los Angeles, California, on October 6 through October 13, 2009, before a Hearing Panel consisting of a former member of the District 2 Committee, a former member of the District 3 Committee, and a Hearing Officer. The witnesses included 15 customers; the spouse of a customer; the branch manager, branch operations manager, and retail compliance manager from Respondent's branch office at his former firm; a FINRA forensic accountant; and Respondent.[2]

I. Respondent

Respondent entered the securities industry in March 1992 after a career as an aerospace engineer. Stip. 1.[3] He joined Dean Witter Reynolds, Inc. in October 1992, and moved to Prudential Securities, Inc. ("Prudential"), where he registered as a general securities representative in the Los Angeles area, on May 30, 1997. In August 1999, he moved to Everen Securities, Inc. ("Everen"), which was acquired by First Union Securities, Inc. ("First Union"), which subsequently merged with Wachovia Securities, LLC ("Wachovia"). Respondent remained at Wachovia until April 2005, when he voluntarily left the firm. Stip. 2; Tr. 1397;

[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.

[2] Respondent attached a statement from his current employer to his post-hearing brief, attesting to his good character. Enforcement has moved to strike the statement. The statement is untimely, and the motion is granted. Even if the statement had been submitted on time, it would have had no effect on the Hearing Panel's views.

[3] References to the exhibits submitted by Enforcement are designated as "CX-___." References to the exhibits submitted by Respondent are designated as "RX-___." The parties submitted a set of stipulations that was received in evidence and marked as JX-1. References to the stipulations are designated as "Stip. __." References to the hearing transcript are designated as "Tr. ___."

CX-1. He has been registered through other firms almost continuously since leaving Wachovia, and remains registered with another FINRA member firm. CX-1.

II. Factual Background

A. Respondent's Sale of Mutual Funds

Early in Respondent's career in the securities industry, while he was a registered representative at Dean Witter, the focus of his practice became working with people who were nearing eligibility for retirement from GTE.[4] Respondent took a six-week course and passed a test that entitled him to use the designation "Retirement Planning Specialist" at Dean Witter. Tr. 1397 – 1398. He continued to use the title in his presentations to clients when he moved to Everen. Tr. 835 – 836; CX-70; CX-130; CX-146.

At least through 2002, GTE employees who were eligible for retirement were offered the option of taking a lump sum in lieu of a pension. Retirement benefits were available to certain employees as early as their early 50s. Most of the retirees who testified at the hearing were about that age when they retired from GTE. Tr. 44, 198, 272, 369, 431 – 432, 469, 607, 661, 950, 1086, 1190, 1407. By the summer of 2000, Respondent had more than 300 customers who were current or former GTE employees. Tr. 1446 – 1447. Respondent's marketing efforts emphasized his focus on handling the GTE lump-sum retirement option. "Being a Retirement Planning Specialist, handling Lump-Sum Distributions has become more than an area of specialty, it has become virtually all I do." CX-70 at 31; CX-130 at 37; CX-146 at 24; CX-194 at 19; CX-231 at 27. He advised one client, "[I]n the past nine years I have worked with over

[4] The precise name of the customers' employer at the time the various witnesses took their lump-sum retirement distributions is unclear. It was once known as General Telephone and Electronics. Some of the customers' retirement documents refer to GTE Network Services. *See, e.g.*, CX-84. According to the Amended Complaint, GTE merged with Bell Atlantic Corp. in June 2000 to form Verizon Communications. Amended Complaint, ¶ 9, fn. 3. Some of the employees ultimately retired from Verizon rather than GTE. Tr. 383, 597, 950. The testimony references both GTE and Verizon. The distinctions are unimportant. For convenenience, this decision refers to the company for which the customers worked and from which they retired as "GTE."

1100 GTE/Verizon employees in helping them sort out their retirement options." CX-12 at 1; see also CX-13 at 1.

Respondent's GTE clients, including those who testified at the hearing, were generally conservative in their investment objectives. Tr. 156 (Mrs. J.T.), 207 (L.Y.), 290 (D.L.), 366 (G.S.), 547 – 548 (C.G.), 666 (E.P.), 1068 – 69 (G.B. and D.B.), 1400. The clients were quite unsophisticated as investors. Most had invested only in the GTE 401(k) plan and its Employee Stock Ownership Plan ("ESOP"), had no other experience in investing, and knew little or nothing about investing, but they trusted Respondent to advise them wisely. Tr. 63 (Mr. J.T.), 158 – 159 (Mrs. J.T.), 194 – 196 (L.Y.), 273 – 277 (D.L.), 365 – 367, 371, 424, 426 (G.S.), 428 – 429, 431 (D.P.), 485, 490 (E.W.), 511, 534 – 536 (C.G.), 607 – 608 (R.J.), 680, 698 (E.P.), 949 – 950 (N.A.), 1017 – 1019, 1031, 1056 (M.K.), 1119 (G.B.), 1146 (D.B.). As an example of their lack of sophistication about investments, several did not know what a mutual fund was. See, e.g., Tr. 474 – 475, 950, 1074, 1142, 1204, 1262.

Some of the customers who testified had no formal education past high school. Tr. 146, 527, 662. Some had taken some college courses. Tr. 271, 320, 420; 467, 1064, 1250 – 1251. One had an associate's degree. Tr. 1014. Only one customer who testified had a four-year college degree, a B.S. in business, but she was extremely unsophisticated and inexperienced as an investor. For example, she did not know what a mutual fund was at the time she invested with Respondent. Tr. 1138, 1142 – 1143. The customers' jobs at GTE were not related to investments or financial matters. Tr. 45 – 46, 145 – 146, 272, 428, 468, 528, 594 – 595, 663, 947, 1065, 1192, 1518.

Respondent has used substantially the same approach for marketing and investments for all of his clients for the 17 years he has marketed to GTE employees. Tr. 1503, 1659; see also

Tr. 1399 et seq. As part of his approach, he prepared a "Retirement Planning Analysis" brochure for each customer. The format and content were substantially the same for each customer, somewhat customized to reflect the specific client's financial situation. The brochures went through the same analysis for each client, including a review of the client's financial situation and of the ten mutual funds that Respondent recommended as investments for the specific client. They also included specific predictions of the performance of the collection of mutual funds that Respondent had recommended for that client, which Respondent called the "overall performance expectation,"[5] and spreadsheets showing the amounts each client could withdraw from the accounts and the balance that would accumulate over time. Tr. 1406, 1441 – 1442; CX-70; CX-130; CX-146; CX-194; CX-231.

Respondent describes himself as an "asset allocator" with respect to his approach to picking mutual funds for his clients' retirement accounts. His methodology generally involved the selection of ten mutual funds for each client's account. The ten categories of mutual funds would include corporate bonds, U.S. government securities, utilities, large-cap growth, large-cap value, large-cap foreign, small-cap U.S., small-cap foreign, mid-cap value, and cash. Tr. 1421 – 1422. The categories were selected so that there was little or no overlap among the holdings of the funds. Tr. 1401, 1420 – 1421, 1544; CX-130; CX-194; CX-231.

Respondent used a computer program called Morningstar Principia Pro as a tool in selecting the ten mutual funds for each client. He selected funds from large families that were at least five years old and continuously managed by the same fund manager for at least two years.

[5] The performance expectation, which Respondent sometimes called the "traditional performance expectation" in his brochures, was linked by an arrow to a calculation of the actual performance over the previous five years of the mutual funds that Respondent had selected. The calculated actual performance was called, "Annual Performance Based on Above Allocation and Fund's 5 Year History." The "performance expectation" was generally slightly lower than the calculated annual performance. See CX-70 at 23; CX-130 at 30; CX-150 at 12; CX-194 at 12; CX-231at 16. By using this slightly lower number, Respondent created the impression that his prediction was conservative.

The funds had to have a sales agreement with his firm and offer shares in the class that he would recommend to his clients. At the times relevant to the Amended Complaint, Respondent recommended Class B shares of the mutual funds.[6] Tr. 1420 – 1421.

An essential feature of Respondent's retirement plan proposals for the clients who testified at the hearing was the ability to make immediate, regular withdrawals from their retirement funds before they were 59 ½, without penalty. See, e.g., CX-70; CX-130; CX-146; CX-194; CX-231. Between April 1998 and April 2005, Section 72(t) of the Internal Revenue Code allowed taxpayers, in certain circumstances, to take IRA distributions before the standard age of 59 ½ without incurring a 10% penalty for early withdrawal. Section 72(t) permitted such distributions provided they were: (i) substantially equal in amount; (ii) constant in interval; and (iii) without modification for at least five years or until the account holder reached the age of 59 ½, whichever was longer. Stip. 8.

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[6] The NAC explained the nature of the three main classes of mutual fund shares in a decision concerning mutual fund switching:

> Generally, each mutual fund is composed of several classes of shares. Each class represents a similar interest in the mutual fund's portfolio of assets. They differ in the sales charges that customers must pay to acquire or sell shares and in amounts that each share class may bear of the fund's expenses.
>
> Class A mutual fund shares usually include an initial, or "front-end," sales charge or "load," a fee that is levied upon the purchase of shares.
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> Class B shares usually include a contingent deferred sales charge ("CDSC"), or "back-end load," which is a fee that is levied upon the sale of mutual fund shares. Typically, the CDSC is reduced with each year that the investor holds the fund shares, phasing out entirely after a certain number of years. At some point afterward, the Class B shares typically convert to Class A shares or another class of shares with lower operating expenses.
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> Class C shares, like B shares, also impose a CDSC. The CDSC for Class C shares is, however, typically eliminated one year after purchase. The expenses associated with each class of shares of a mutual fund are expressed in the form of an operating expense ratio which measures a fund's total annual expenses as a percentage of the fund's net assets. The expense ratio includes asset-based sales charges, such as charges permitted under Investment Company Act Rule 12b-1, that are taken from the mutual fund's assets to pay to market the fund and distribute its shares. The expense ratios for Class B and Class C shares are generally higher than the expense ratio for Class A shares because the asset-based sales charges associated with Class A shares are lower. Since Class C shares generally do not convert to another class of shares, the typically higher operating expenses associated with them are ongoing and continue until the shares are sold.

Dep't of Enforcement v. Epstein, No. C9B040098, 2007 FINRA Discip. LEXIS 18, at *18 n.6 (N.A.C. Dec. 20, 2007), *aff'd*, Exchange Act Rel. No. 59328, 2009 SEC LEXIS 217 (Jan. 30, 2009), *appeal docketed*, Case No. 09-1550 (3d Cir. Feb. 24, 2009).

Fifteen customer witnesses testified at the hearing. Their investments with Respondent were as follows:

- Customer N.A. invested about $300,000 that he received upon retirement from GTE in 1999, and purchased Class B shares in ten mutual funds as recommended by Respondent. He made regular withdrawals from the account, pursuant to IRC § 72(t). Tr. 947, 951; CX-618; CX-634; Answer to Amended Complaint ¶ 13.

- Customers G.B. and his wife, D.B., invested a total of about $438,000 with Respondent. In 1998, G.B. deposited his GTE lump-sum pension distribution and an inheritance in his IRA, for a total of about $275,000, and authorized Respondent to purchase B shares of ten mutual funds. He opened a second account with $150,000 he inherited. By September 1999, he had about $420,000 invested in his account with Respondent, all in Class B shares of ten mutual funds. Tr. 1085 – 1088; CX-619; CX-634. D.B., who was not a GTE employee, opened an IRA with Respondent with about $17,500. Tr. 1138, 1147; CX-619; CX-634. G.B. and D.B. took regular withdrawals from their accounts pursuant to IRC § 72(t). CX-619; CX-634.

- Customer C.G. retired from GTE in January 1999 and invested about $385,000 with Respondent, all in Class B shares of ten mutual funds. He made regular withdrawals pursuant to IRC § 72(t). Tr. 527 – 528, 540; CX-621; CX-634; Answer to Amended Complaint ¶ 16.

- Customer R.J., a former GTE employee, funded his rollover IRA with about $370,000 in June 2002. Respondent purchased $333,675 in Class B shares of ten mutual funds. R.J. made regular withdrawals pursuant to IRC § 72(t). Tr. 594 – 595, 609 – 612, 631; CX-622; RX-9; Answer to Amended Complaint ¶ 17.

- Customer M.K. retired from GTE in 1996. She was approximately 65 years old when she first invested about $53,000 with Respondent in July 1999. Respondent invested M.K.'s funds in Class B shares of nine mutual funds. M.K. made frequent withdrawals from her account in amounts greater than contemplated by her retirement plan. Because she was already past 59 ½ when she opened the account, her withdrawals were not pursuant to IRC § 72(t). Tr. 1016, 1020, 1032 – 1033, 1039 – 1040, 1044, 1054; CX-121; CX-623; CX-634; Answer to Amended Complaint ¶ 18.

- Customer D.L. retired from GTE in January 1999, and invested her retirement funds of about $400,000 in an IRA with Respondent. The funds were used to purchase Class B shares of ten mutual funds. She took regular monthly withdrawals pursuant to IRC § 72(t). Tr. 273, 297 – 298, 302; CX-608; CX-624; CX-634; Answer to Amended Complaint ¶ 19.

- Customer D.P. retired from GTE and opened his account with Respondent in 1998. He deposited $454,000, which was invested in Class B shares of ten mutual funds. He did not make regular withdrawals pursuant to IRC § 72(t). Tr. 428, 421, 442 – 443; CX-608; CX-626; CX-634; Answer to Amended Complaint ¶ 21.

- Customer E.P. retired from GTE and opened his account with Respondent in 1999, depositing about $575,000, which was invested in Class B shares of ten mutual funds. He took regular distributions pursuant to IRC § 72(t). Tr. 662, 678, 680 – 681; CX-625; CX-634; Answer to Amended Complaint ¶ 20.

- Customer M.R. retired from GTE in 1999, and invested about $250,000 with Respondent, which was invested in Class B shares of ten mutual funds. He made regular

withdrawals pursuant to IRC § 72(t). Tr. 1192, 1201 – 1202, 1206 – 1207, 1214; RX-57; CX-627; CX-634; Answer to Amended Complaint ¶ 22.

- Customer G.S. retired from GTE in March 2002, and invested his lump-sum retirement funds of $275,000 with Respondent. His funds were invested in Class B shares of ten mutual funds. He did not make regular withdrawals pursuant to IRC § 72(t). Tr. 368, 371, 386 – 388; CX-628; CX-634; Answer to Amended Complaint ¶ 23.

- Customers Mr. J.T. and Mrs. J.T., both GTE retirees, invested a total of about $900,000 with Respondent in January 1999. Their funds were invested in Class B shares of ten mutual funds. Mr. and Mrs. T. made regular withdrawals from their accounts pursuant to IRC § 72(t). Tr. 45 – 46, 71, 81, 148, 160 – 162; CX-629; CX-734; RX-63; Answer to Amended Complaint ¶ 25.

- Customer E.W., a GTE retiree, invested her retirement money of about $245,000 with Respondent in 1999. Her funds were invested in Class B shares of ten mutual funds. She made regular withdrawals pursuant to IRC § 72(t). Tr. 482 – 483, 486, 489; CX-630; CX-634; Answer to Amended Complaint ¶ 27.

- Customer L.Y. retired from GTE in 2002. She opened an account with Respondent, depositing about $260,000, which was invested in Class B shares of ten mutual funds. She took regular monthly withdrawals pursuant to IRC § 72(t). Tr. 197 – 198, 219 – 220; RX-31; CX-608; CX-631; CX-634; Answer to Amended Complaint ¶ 26.

B. Mutual Fund Switches

Starting in about March 2000, the stock market declined for a substantial period, and the balances in the accounts of Respondent's customers declined. About a year after the start of the decline, Respondent started to receive calls from clients who were concerned about the decline in

the value of their investments. Tr. 1446 – 1447; see Answer to Amended Complaint ¶¶ 10 – 27. At first, Respondent recommended that his clients "stay the course." Tr. 1664. Two of the customer witnesses testified that when they called him to express their anxiety about the decline in their portfolios, he told them to "hang in there." Another said he simply responded that the market was bad, and there was nothing he could do about it. Tr. 681, 963, 1149.

In 2001 and 2002, however, Respondent recommended and effected a total of 359 switch-related trades in the accounts of 12 customers, almost all from B shares to C shares.[7] CX-608;[8] Tr. 1665. Respondent testified that he discussed the switches with his customers. Tr. 1494 – 1496, 1505 – 1507, 1548 – 1549, 1568. Some customers agreed that they had discussed the switches with Respondent and had authorized the switches. Tr. 132; 395 – 396, 416, 445 – 447, 682, 1092 – 1093. Some customers, however, disputed that they had such a discussion, or even that they knew about the switches. Tr. 307 – 308, 551 – 553. Customer N.A. testified that he discussed replacing only one poorly performing fund, although Respondent sold all ten of the funds in which N.A. was invested and reinvested in C shares of other funds. Tr. 963 – 964; CX-608.[9]

When picking the new funds into which he switched his clients, Respondent used the same evaluation process that he had used with the initial selection of funds. Tr. 1449 – 1450, 1666 – 1667. Respondent found that there was not a single equity fund worth keeping from the original selections, and all were liquidated. Tr. 1669. In a second round of switches, he sold

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[7] The customers who were switched were N.A., G.B., D.B. (in her joint account with G.B.), C.G., D.L., E.P., D.P., M.R., G.S., Mr. J.T., Mrs. J.T., and E.W. CX-608. There were no unsuitable switches alleged for the accounts of M.K., R.J., or L.Y. The only switch that was not to C shares was in the account of M.A., in which Class A shares of one fund were purchased. CX-608.

[8] As Enforcement explained, these transactions include both Respondent's redemption of the customers' existing B shares and the purchase of a like amount of C shares. Two of these switches were from B shares to A shares.

[9] As discussed below, the Hearing Panel found the testimony of those who said that switch transactions were effected without authorization to be credible.

even U.S. Government funds and switched to aggressive growth funds in an effort to "turn this thing around." Tr. 1670. He testified that it was his intention that his clients would keep the C shares for only a year "to catch our breath," and to see where the market went, and that he advised his clients of that strategy. Tr. 1448 – 1449, 1457, 1466, 1498.

In his initial sales presentation, Respondent had discussed the importance of investing in large fund families with his clients. Tr. 1541. In his Retirement Planning Analysis, he told each of his clients, "Each of the five families chosen are chosen on the basis of their integrity in the industry as well as the large number of different funds in their respective families. (This will allow us to make subtle changes within the portfolio without charge or limitations)." CX-70 at 30; CX-130 at 36; CX-146 at 23; CX-231 at 26. Respondent did not feel that his recommendations to switch to funds in different fund families were inconsistent with the representations in his brochures. Although the brochures referenced the ability to make "subtle changes" within fund families without incurring charges, in Respondent's view such changes would not have addressed his clients' concerns. Respondent believed it was necessary to change fund families. Tr. 1546 – 1547.

The sale of the customers' Class B shares caused them to incur contingent deferred sales charges. One couple, Mr. J.T. and Mrs. J.T., incurred $17,964 in CDSCs. Others also incurred substantial charges, totaling $84,240 in CDSCs for the 12 customers. CX-605. Respondent received commissions of $36,516.14 for the switch transactions. CX-602; CX-608; Tr. 1323 – 1324.

Despite the CDSCs, Respondent testified that the switching to C shares in different mutual fund families was in his clients' best interest because the anticipated gains from the better performance of the newly selected funds would substantially exceed the CDSCs, which

amounted to approximately 2%. Tr. 1449 – 1450, 1551, 1665 – 1667. He rejected the idea that it would have been in his customers' best interest to look for funds within the same fund families to avoid the CDSCs, because, in his opinion, if "the XYZ fund family had a stinker for their growth fund, they are probably not going to be too excelling elsewheres. Checked that enough that I'm satisfied that the fund family is in a little bit of disarray. I would have better luck just starting fresh with C shares." Tr. 1641.

III. Discussion of the Five Causes of Action

The Hearing Panel finds that Enforcement has established that Respondent violated FINRA's rules with respect to each of the five causes of action in the Amended Complaint: fraudulent misrepresentations; unsuitable mutual fund switching; unauthorized trading; discretionary trading without written authorization; and causing his firm's books and records to be inaccurate by submitting inaccurate reports.

A. Respondent Made Fraudulent Misrepresentations in Violation of Section 10(b) of the Securities Exchange Act of 1934, SEC Rule 10b-5, and NASD Conduct Rules 2120 and 2110

1. Respondent Made the Representations Alleged in the Amended Complaint

The Amended Complaint charges Respondent with making three misrepresentations to multiple customers:

a. they could live off market gains, interest, and dividends without experiencing a reduction in their principal;

b. they would receive returns as high as 9 – 13%; and

c. they could live as well in retirement as they could if they were still working.

Amended Complaint ¶ 21.

Respondent made each of the misrepresentations alleged. He provided high and unrealistic performance projections to his clients. He told clients that he would "elect a

conservative investment portfolio," yet projected returns of 9% far into the future. CX-70 at 28; CX-150 at 10; CX-194 at 16. For client L.Y., he recommended a "moderately aggressive investment portfolio" to achieve an estimated rate of return of 12%, although she had told Respondent that she did not want a lot of risk. CX-231 at 23 – 24; Tr. 212. His presentation to customer D.L. recommended a conservative portfolio "to achieve the estimated 8% rate of return," but in the same presentation discussed an "8.0 – 10.1% overall performance expectation," noting the recommended portfolio's annual performance of 11.47% based on its five-year history. CX-130 at 30, 34. He noted similar performance for the portfolio he recommended for customer M.K. CX-122 at 3. In meetings with clients, he presented estimates of higher rates of return. He told customers Mr. J.T. and Mrs. J.T. that their investments would grow at 10 – 12%. Tr. 54 – 55. Customer G.S. recalled a chart showing a "conservative" rate of return of 12%. Respondent told Customer D.P. that he could expect estimated returns of 8 – 12%, and told Customer C.G. said that he could expect to earn close to 18%. Tr. 440, 533, 538. Respondent's estimated rates of return were reinforced by his predictions to some customers that he would make them millionaires. Tr. 205, 286, 664 – 665, 1260; CX-130 at 8; CX-150 at 7; CX-231 at 13.

Respondent told customers that they could live off their market gains, interest, and dividends without experiencing a reduction in principal, as charged in the Amended Complaint. His written materials represented that the plan would preserve his clients' principal, and their IRAs would "continue to grow substantially over the years." CX-70 at 28; CX-130 at 34; CX-146 at 21; CX-194 at 16; CX-231 at 23. He told clients that they could retire and not have to work again. Tr. 147 – 148, 667, 674, 1084. In his in-person presentations, he also told clients

that they could live off the income from their retirement funds without touching principal. Tr. 46, 50, 151, 155, 178, 668, 1028, 1071, 1140, 1202 – 1203.

In both written and oral presentations, Respondent told his customers that they could live as well in retirement as if they were still working. The Retirement Action Plan, which was part of the Retirement Planning Analysis brochures, advised clients that the plan was designed to address his clients' concerns, one of which was to "Allocate Lump-Sum in a way that generates the income needed to provide a retirement paycheck that will allow you the freedom of enjoying new ventures without counting on any outside job income 'to make ends meet.'" CX-70 at 27; CX-130 at 33; CX-150 at 9; CX-194 at 15; CX-231 at 21. One of the key concerns addressed in the brochures was to "construct [a] retirement plan so as to account for an increasing standard-of-living in the face of expenses inflation." CX-70 at 27; CX-130 at 33; CX-150 at 9; CX-194 at 15; CX-231 at 21. He told Mr. J.T. and Mrs. J.T. that they could live comfortably the rest of their lives, with the same or better lifestyle. Tr. 46, 50, 147 – 148. He made similar representations to other customers. Tr. 214 – 215, 292 – 293, 377, 532, 674, 1070 – 1071. He told customer L.Y. that she could send her two grandchildren through college, yet, as discussed above, take regular distributions and still become a millionaire. Tr. 203 – 204; CX-231 at 21.

2. Respondent's Representations Were Fraudulent

Section 10(b) of the Exchange Act provides that it is "unlawful for any person … to use or employ, in connection with the purchase or sale of any security …, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe."[10] SEC Rule 10b-5 makes it unlawful "[t]o employ any device, scheme, or artifice to defraud; to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances in which they were made, not misleading; or

[10] 15 U.S.C. § 78j(b).

to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."[11] To establish a violation of Rule 10b-5, Enforcement must demonstrate by a preponderance of the evidence that the Respondent: (1) made misrepresentations or omissions of material facts; (2) acted with scienter; and (3) made such misrepresentations or omissions in connection with the purchase or sale of a security. In addition, Enforcement must show that Respondent used "any means or instrumentality of interstate commerce, or of the mails or of any facility of any national security exchange."[12] NASD Conduct Rule 2120, FINRA's antifraud rule, is similar to Rule 10b-5.[13] A violation of Rule 2120 or SEC Rule 10b-5 also is a violation of NASD Conduct Rule 2110.[14]

Respondent's representations to his clients were fraudulent. His representations would lead reasonable investors, especially unsophisticated investors like his clients, to believe that they were all but certain to earn high rates of return, enabling them to retire in their early 50s and live comfortably in retirement without having to work again. His entire presentation was designed to lead his clients to believe that if they trusted their money to Respondent, their comfortable retirements were assured. Respondent touted himself as a retirement specialist who had counseled more than 1,100 GTE retirees on investing their lump-sum retirement distributions, and thus was someone on whom his clients could rely. Their lack of investment sophistication and their trust in Respondent left them vulnerable to his exaggerated claims.

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[11] 17 C.F.R. § 240.10b-5.

[12] *Dep't of Enforcement v. Kaweske*, No. C07040042, 2007 NASD Discip. LEXIS 5, at * 25 – *26 (N.A.C. Feb. 12, 2007).

[13] *Dep't of Enforcement v. Kirlin Securities*, No. EAF0400300001, 2009 FINRA Discip. LEXIS 2, at *39 (N.A.C. Feb. 25, 2009), *aff'd*, Exchange Act Rel. No. 61135, 2009 SEC LEXIS 4168, at *42 (Dec. 10, 2009).

[14] *Kirlin*, 2009 SEC LEXIS 4168, December 10, 2009. at *60 n. 81 ("It is well established that a violation of a Commission or NASD rule or regulation is inconsistent with just and equitable principles of trade, and is therefore also a violation of Rule 2110.")

He presented his projections as conservative, consistent with his clients' conservative objectives. He assured his clients that they could retire and take regular monthly distributions from the IRAs he would set up for them, living as well or better in retirement as they did while working. They would be free to pursue new ventures, and not have to take other jobs. His projections and verbal representations assured his clients that their money would last the rest of their lives, and that some would become millionaires. These representations made sense only if Respondent's clients could depend on receiving the returns that Respondent predicted. While Respondent might not have used the term "guarantee," his assurances to his clients that they could make crucial decisions about their financial futures based on his predictions were tantamount to guarantees.

The Hearing Panel does not believe there can be a sound basis for making such predictions with the kind of certainty that permeated Respondent's presentations. Respondent could not articulate a sound basis for making his predictions. [15] While Respondent argues that the misrepresentations were mere predictions and not facts, "predictions of specific and substantial increases in the price of any security … that are made without a reasonable basis are fraudulent."[16] Further, Respondent's violation "is not ameliorated … where the positive

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[15] Although his explanation was confusing at best, Respondent did not derive the "conservative" expected return of 9% from a specific formula or index. He disputed the applicability of such indices as the IRS determination for corporate pension funds or a Pension Benefit Guaranty Corporation index. Instead, he claimed that he based his predictions on looking at the S&P 500 and a basket of mutual funds. Tr. 1648 – 1653. Respondent was evasive in responding the the Hearing Panel's inquiry concerning the basis for his predictions, and the Hearing Panel did not find this testimony credible. Whatever methodology Respondent actually used, the result was always unreasonably optimistic projections. From the beginning of this proceeding and throughout the hearing, Respondent and his counsel referred repeatedly to the "Tech Wreck," the three-year market decline that began in about March 2000 (Answer to Complaint ¶¶ 3, 10 – 27; Tr. 1453), yet his projections were the same, or more aggressive, in 2002 as in 1998. For example, he projected a 12% rate of return on a moderately aggressive investment portfolio for customer L.Y. in February 2002. CX-231 at 24. Similarly, in annual financial reviews for two customers in the spring of 2002, Respondent projected anticipated growth of 14.91% (CX-158 at 4) and 11.87% (CX-177 at 2), based on the five-year performance of the customers' funds.

[16] *Kevin M. Glodek*, Exchange Act Rel. No. 60937, 2009 SEC LEXIS 3936, at *13 – *14 (Nov. 4, 2009); *Steven E. Muth*, Exchange Act Rel. No. 52551, 2005 SEC LEXIS 2488, at *27 – *28 (Oct. 3, 2005).

prediction about the future performance of securities is cast as opinion or possibility rather than as a guarantee."[17] The Hearing Panel finds that Respondent made the misrepresentations alleged in the Amended Complaint.

There can be no doubt that the misrepresentations were material. A fact is material if there is a substantial likelihood that a reasonable investor would have considered the misstated or omitted fact important in making an investment decision, and if disclosure of the misstated or omitted fact would have significantly altered the total mix of information available to the investor.[18] Price or earnings predictions are material representations.[19] Respondent's misrepresentations were the core of Respondent's presentation to his clients, and altered the total mix of information available to the investors.

There can also be no doubt that Respondent's misrepresentations were made in connection with the purchase and sale of securities. The misrepresentations were designed to induce Respondent's clients to adopt the Retirement Action Plan presented in Respondent's brochures, which involved investing substantial sums through Respondent in ten mutual funds.[20]

Respondent made his misrepresentations with scienter. Scienter is "a mental state embracing intent to deceive, manipulate or defraud," and may include intentional or reckless

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[17] *Dep't of Enforcement v. Glodek*, No. E9B2002010501, 2009 FINRA Discip. LEXIS 1, at *15 (Feb. 24, 2009) (citations omitted), *aff'd*, Exchange Act Rel. No. 60937, 2009 SEC LEXIS 3936 (Nov. 4, 2009), citing *SEC v. Hasho*, 784 F. Supp. 1059, 1109 (S.D.N.Y. 1992).

[18] *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988); *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

[19] *Kevin M. Glodek*, Exchange Act Rel. No. 60937, 2009 SEC LEXIS 3936, at * 7 (Nov. 4, 2009); *SEC v. Hasho*, 784 F.Supp. 1059, 1109 (S.D.N.Y. 1992); *Steven E. Muth*, Exchange Act Rel. No. 8622, 1995 SEC LEXIS 2488, at * 45 (Oct. 3, 1995).

[20] Respondent used "means or instrumentalit[ies] of interstate commerce, or of the mails or of any facility of any national security exchange." All of the clients's funds were invested in multiple mutual funds in large fund families. They included corporate bonds, U.S. government securities, utilities, large-cap growth, large-cap value, large-cap foreign, small-cap U.S., small-cap foreign, mid-cap value, and cash. Respondent was registered with national firms and maintained his clients' accounts at those firms. Tr. 1421 – 1422; CX-1, CX-618, CX-619, CX-621 – CX-631, Stip. 1, 2.

conduct.[21] Reckless conduct includes “a highly unreasonable omission, involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.”[22] Respondent clearly knew that he was making predictions that were intended to induce his clients to invest with him, and with his level of experience and sophistication, he must have known that the certainty with which he predicted the substantial retirement incomes for his clients, and their financially comfortable and carefree retirements, was not realistic.

By making material misrepresentations, Respondent violated Section 10(b) of the Securities Exchange Act of 1934, SEC Rule 10b-5, and NASD Conduct Rules 2120 and 2110.

3. Failure to Disclose Material Facts

The Amended Complaint alleges that Respondent failed to make material disclosures to certain customers concerning the different types of shares available for investment; the sales charges and operating expenses associated with each share class and their effect on potential returns; the potential CDSCs that could be levied upon the sale of these shares; the availability of breakpoints; the ability to take advantage of rights of accumulation by investing in concentrated fund families; and the cost-saving options that were available instead of switching. Amended Complaint ¶ 22.

Enforcement failed to prove that there was a material omission with respect to the availability of breakpoints or rights of accumulation. There is no evidence in the record that any of the clients who testified could have taken advantage of breakpoints or rights of accumulation.

[21] *Dep’t of Enforcement v. Frankfort*, No. C02040032, 2007 NASD Discip. LEXIS 16, at * 26 – *27 (N.A.C. May 24, 2007) (citations omitted).

[22] *Frankfort* at *27 (citations omitted).

If they were eligible for breakpoints or rights of accumulation, there is also no evidence of how much the benefit would have been, and therefore whether the amounts would have been material in light of the clients' overall investment objectives.

The Hearing Panel also finds that Respondent did not fail to disclose the types of shares available for investment. Three customers recalled that Respondent discussed the different share classes. Tr. 61, 436, 668 – 669. Respondent testified that part of his standard presentation was to discuss the different share classes. Tr. 1423 – 1424. Such a discussion would have been logical in light of the statement in the Retirement Action Plans concerning how the fund families were chosen: "Each of the five families chosen are chosen on the basis of their integrity in the industry as well as the large number of different funds in their respective families. (This will allow us to make subtle changes within the portfolio without charge or limitations)." CX-70 at 30; CX-130 at 36; CX-146 at 23; CX-231 at 26. In addition, the customers generally were not interested in A shares. Tr. 61, 438, 1425. In light of the passage of time, the somewhat technical nature of the information, and the lack of customer interest in A shares, the Hearing Panel finds that the testimony of those who did not remember any discussion of the share classes was not reliable on this topic, and finds that Respondent explained the different classes of shares to his customers.

As alleged in the Amended Complaint, Respondent did not disclose to his clients that there were cost-saving options available instead of switching. He told Mr. and Mrs. J.T. that there would be a 1% fee for switching from Class B shares to C shares, but did not tell them that they could avoid the CDSC altogether by staying in the same fund family. Tr. 83 – 84. Similarly, he did not tell other customers that they could avoid fees by switching within the same fund families. Tr. 397 – 398 (G.S.), 448 (D.P.), 685 – 687, 730 (E.P.), 1092 – 1093, 1117 – 1118

(G.B.), 1213 (M.R.). A registered representative owes such a duty to his clients to disclose material information fully and completely when recommending a transaction.[23] "Information is material if there is a substantial likelihood that a reasonable [investor] would consider it important in deciding how to [invest] ... and the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[24]

Avoiding a substantial fee for switching mutual funds would clearly alter the total mix of information available to a reasonable investor. In fact, as discussed in the next section, causing a client to incur such a fee by switching mutual funds is presumptively unsuitable. Respondent failed to disclose the information in the context of the purchase and sale of mutual fund shares. By failing to disclose that the CDSCs could be avoided by switching within fund families, Respondent violated Section 10(b) of the Securities Exchange Act of 1934, SEC Rule 10b-5, and NASD Conduct Rules 2120 and 2110.

B. Respondent Recommended Unsuitable Mutual Fund Switches in Violation of NASD Conduct Rules 2310 and 2110, and IM-2310-2

The Second Cause of Action charges Respondent with recommending unsuitable switches from Class B to Class C shares of mutual funds in violation of NASD Conduct Rules 2310, 2110, and IM-2310-2.

NASD Rule 2310(a) requires that a registered representative, before recommending the purchase, sale, or exchange of any security, "have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customers as to his other security holdings and financial situation and needs." "'A pattern

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[23] *Dep't of Enforcement v. Frankfort*, No. C02040032, 2007 NASD Discip. LEXIS 16, at *20 (N.A.C. May 24, 2007).

[24] *Id.* at *24 (internal quotations and citation omitted).

of switches from one fund to another by several customers of a registered representative, where there is no indication of a change in the investment objectives of the customers and where new sales loads are incurred, is not reconcilable with the concept of suitability.' Where such a pattern is established, it is incumbent upon the registered representative that recommended such switches to demonstrate the unusual circumstances which justified what is a clear departure from the manner in which mutual fund investments are normally made."[25] A registered representative "must evaluate the net investment advantage of any recommended switch from one fund to another" and must be able to demonstrate the rationale for the recommendation based upon the information obtained from the customer for the purpose of making a suitability determination.[26] A pattern of mutual fund switching is a presumptive violation of Rule 2310(a).[27]

Respondent engaged in wholesale switching of 12 of the customers who testified, switching them out the funds he had recommended when they first invested with him. The investment objectives of the customers who were switched had not changed.[28] Respondent was responding to concerns about declines in the value of their holdings and the market. Such a rationale for switches has been rejected. "Among other things, the Commission has found that 'a

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[25] *Dep't of Enforcement v. Epstein*, No. C9B040098, 2007 FINRA Discip. LEXIS 18, at *67 (N.A.C. Dec. 20, 2007), *aff'd*, 2009 SEC LEXIS 217 (Jan. 30, 2009), *appeal docketed*, No. 09-1550 (3d Cir. Feb. 24, 2009) (citations omitted).

[26] *NASD Notice to Members 94-16.*

[27] *Dep't of Enforcement v. Respondent*, No. C07010037, 2003 NASD Discip. LEXIS 16, at *22 – *23 (N.A.C. May 13, 2003).

[28] Respondent switched customers N.A., D.L., and others toward more aggressive, growth-oriented portfolios. Tr. 1562, 1565, 1572 – 1577, 1669 – 1670. Respondent explained the switch to more aggressive funds as an attempt to recover the losses from the market decline: "We're looking for ways to turn this thing around." Tr. 1670. There is no evidence that the customers' objectives changed toward more aggressive investing, so this cannot be a justification for the switches. Rather, it goes against his clients' conservate investment objectives.

generally declining market' or a fund's 'poor performance' were not sufficient reasons to rebut the presumption of improper mutual fund switches."[29]

Respondent's switches caused his customers to incur substantial CDSC expenses – almost $18,000 for one customer, and an average of more than $7,000 for the 12 customers. By switching his customers who had been in B shares, in some cases for three years, he also deprived his customers of the opportunity to convert from B shares to the lower-cost A shares that would have become available in about three years, after they had owned the Class B shares for six years. Tr. 1423 – 1425.

Wilson did not fully inform his customers of the consequences of the switches. For example, he told customer N.A. that there would be a 1% fee, when, as noted above, the actual CDSC was about 2%. Tr. 83 – 84. To other customers, he did not mention the CDSC at all, or did not tell them the amount. Tr. 396, 550, 685 – 687, 730, 1092 – 1093, 1117 – 1118, 1213. Wilson also did not inform his customers that they could avoid paying fees altogether by switching within the families of the funds they already owned. Tr. 83 – 84, 397 – 398, 448. The NAC has considered the failure to inform customers of the availability of funds without sales charges in the same fund family as the customers' initial mutual families to be a factor in determining whether a switch was unsuitable.[30] This omission is particularly egregious because

[29] *Epstein*, 2007 NASD LEXIS 18 at *73, n.32. The NAC cited *Charles E. Marland & Co., Inc.*, 45 S.E.C. 632, 634-35 (1974), and noted the finding in *Winston H. Kinderdick* that it was implausible that mutual fund switch transactions were suitable due to a desire for better performance. *See Winston H. Kinderdick,*, 46 S.E.C. 636, 638, 1976 SEC LEXIS 783, at *5 (Sept. 21, 1976).

[30] *Epstein*, 2007 FINRA Discip. LEXIS 18, at *68 – *69. The NAC cited to a 2002 switching decision in support of this proposition. See *Dep't of Enforcement v. Belden*, No. C05010012, 2002 NASD Discip. LEXIS 12, at *15 (N.A.C. Aug. 13, 2002) ("[A] registered representative violated the suitability rule when he recommended the purchase of mutual fund shares without having reasonable grounds for believing that such transactions were suitable for the customer in light of the customer's ability to purchase funds with similar investment objectives within the mutual fund families without incurring a sales charge."), *aff'd*, Exchange Act Rel. No. 47859, 2003 SEC LEXIS 1154 (May 14, 2003).

Respondent had represented the ability to move within fund families as an important advantage of his proposed investment strategy in his initial presentations to his customers.

When Respondent recommended a switch out of the original funds, he ran the Principia Pro analysis prior to making the switches, and, came up with a new set of recommendations. He made no apparent effort to determine whether the improved performance would be sufficient to justify the expense, apparently because of his view that if a fund had performed poorly, none of the funds in a fund family would be top performers. Since Respondent claimed that his intention was to move for only about a year, the other funds would have to be able to perform at least 2% better for that year to justify paying the CDSC to make the switch worthwhile for that year alone. The 2% CDSC understates the cost of the switch, however. Respondent would also have to be able to show that the benefits of the switch were sufficient to overcome the higher fees for the C shares, plus losing the three or more years that had been earned during the period the clients held the B shares toward the conversion of the B shares to lower-cost A shares.

Despite his professed belief that if one fund in a fund family performed poorly, the rest of the funds in that family would also not perform well, he did, in fact, move customers out of Oppenheimer and Alliance B shares and into C shares of different Oppenheimer and Alliance funds. CX-608.[31] Had he moved those customers to B shares in the new Oppenheimer and Alliance funds, he could have saved the CDSCs that his clients incurred by moving from B shares to C shares.

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[31] He moved N.A. out of B shares of one Oppenheimer fund and into C shares of two Oppenheimer funds; customer G.B. out of B shares of one Alliance fund and into C shares of an Alliance fund; G.B. and D.B.'s Family Trust out of B shares of two Alliance funds and into C shares of one Alliance fund; C.G. out of B shares of two Alliance funds and into C shares of two Alliance funds; D.L. out of B shares of two Alliance funds and into C shares of one Alliance fund; E.P. out of B shares of two Alliance funds and into C shares of one Alliance fund; D.P. out of B shares of two Alliance funds and into C shares of one Alliance fund; G.S. out of B shares of two Alliance funds and into C shares of one Alliance fund; Mr. J.T. out of B shares of two Alliance funds and into C shares of one Alliance fund; Mrs. J.T. out of B shares of two Oppenheimer funds and one Alliance fund, and into C shares of one Oppenheimer fund and one Alliance fund; and E.W. out of B shares of one Oppenheimer fund and into C shares of two Oppenheimer funds. CX-608.

Respondent contends that the customers agreed to the switches, or even initiated the process of doing something to "stop the bleeding" of the declining market. The NAC has rejected this rationale. "A recommendation is not suitable merely because the customer acquiesces in the recommendation. Rather, the recommendation must be consistent with the customer's financial situation and needs."[32]

The Hearing Panel finds that Respondent's recommended switches of the 12 customers who were switched from Class B shares to Class C shares were unsuitable in violation of NASD Conduct Rules 2310 and 2110, and IM-2310-2.

C. Respondent Engaged in Unauthorized Trading in Violation of NASD Conduct Rule 2110 and IM-2310-2

In the Third Cause of Action, the Amended Complaint charges Respondent with engaging in unauthorized trading by switching certain customers from B shares to C shares without their knowledge, authorization, or consent. While several of Respondent's customers said they were consulted about the mutual fund switches, others denied that they had authorized or even had knowledge of the switches. In particular, Enforcement contends that Respondent effected 102 switches in the accounts of N.A., E.W., and D.L. without their knowledge, authorization, or consent.

Customer D.L. had not been aware in 2001 that Respondent sold B shares and bought Class C shares in her account. Tr. 307 – 309. At the end of 2001, customer E.W. was surprised at all the sales transactions in her account. Tr. 491 – 494. Specifically, she testified that she did not authorize Respondent to sell B shares in her account. Tr. 494. In October 2001, Respondent recommended to customer N.A. that he replace one fund that was performing poorly, and N.A.

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[32] *Epstein*, 2007 FINRA Discip. LEXIS 18, at *66, n.28, quoting *Dane S. Faber*, Exchange Act Rel. No. 49216, 2004 SEC LEXIS 277, at *24 (Feb. 10, 2004).

agreed to the transaction. N.A. did not authorize Respondent to sell all ten of his funds. Tr. 963 – 967.

The Hearing Panel finds that the testimony of the customer witnesses was credible, and that Respondent engaged in unauthorized trading in the accounts of N.A., D.L., and E.W., in violation of NASD Conduct Rule 2110 and IM-2310-2.

D. Respondent Engaged in Discretionary Trading Without Written Authorization in Violation of NASD Conduct Rules 2510(b) and 2110

Rule 2510(b) prohibits a registered representative from exercising any discretionary power in a customer's account unless such customer has authorized the exercise of discretion in writing, and the account has been accepted by the representative's firm as a discretionary account. A general understanding of an investment strategy is not a grant of discretion, and trading pursuant to such an understanding is a violation of Rule 2510 and 2110.[33]

The parties stipulated that Respondent did not have any discretionary accounts during the period from April 1998 to April 2005. Stip. 7. Furthermore, Everen, First Union, and Wachovia prohibited discretionary trading in IRAs. Tr. 774; CX-637 at 33.

Respondent set up his clients' IRAs with enough money in their money market funds to pay distributions for about the first year and a half. Tr. 1460. When something needed to be sold to make a distribution, Respondent would decide what to sell. He testified that his sales assistant would contact the clients either at the time or a day or two later. Tr. 1463 – 1464, 1612, 1618. A number of customers denied that they were called at all when Respondent sold shares to fund their 72(t) distributions. Tr. 78, 304, 500 – 501, 557, 621, 681, 969 – 970, 1214 – 1215. The Hearing Panel finds the customers' testimony more credible, both because of the consistency

[33] *Raghaban Sathianathan*, Exchange Act Rel. No. 54722, 2006 SEC LEXIS 2572, at *34 – *35 (Nov. 8, 2006), *aff'd*, 304 F. App'x 883 (D.C. Cir. 2008).

of their recollection and Respondent's somewhat cavalier attitude toward contacting the customers.[34]

Respondent exercised discretion in his customer's accounts without written authorization from either his customers or his firm, and thereby violated Rule 2510(b).

E. Respondent Caused the Books and Records of His Firm to Be Inaccurate in Violation of NASD Conduct Rules 3110 and 2110

NASD Conduct Rule 3110(a) provides, "Each member shall make and preserve books, accounts, records, memoranda, and correspondence in conformity with all applicable laws, rules, regulations and statements of policy promulgated thereunder and with the Rules of this Association and as prescribed by SEC Rule 17a-3." Entering inaccurate information into a firm's books and records violates both Rule 2110's requirement that members observe high standards of commercial honor and just and equitable principles of trade and Rule 3110's requirement to keep accurate books and records.[35]

1. Respondent Caused His Firm's Switch Logs to Be Inaccurate in Violation of NASD Conduct Rules 3110 and 2110

When Respondent was at First Union, the firm's procedures required that when a customer switched from one mutual fund to another, the firm would send a "switch letter" to the customer documenting the switch, describing in detail what was sold and what was purchased. Tr. 743 – 744, 808 – 809. First Union maintained a record, called the "ICP [investment company product] switch log" to document that a switch letter had been sent each time a customer switched mutual funds, and also as a management tool. One type of information recorded on the

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[34] Even under Respondent's version of the events, Respondent made the trades without prior client approval.

[35] *Dep't of Enforcement v. Nouchi*, No. E102004083705, 2009 FINRA Discip. LEXIS 8, at *6 (N.A.C. Aug. 7, 2009), citing *Fox & Co. Inv., Inc.*, Exchange Act Rel. No. 52697, 2005 SEC LEXIS 2822, at *30 – *32 (Oct. 28, 2005).

switch log was the reason for the switch, information that was provided by the firm's registered representatives. Tr. 743 – 744, 749 – 754, 816 – 818, 882; CX-638; CX-639; CX-640.

Respondent reported the reason for customer G.B.'s switches as "to allow client annual allocation out of C shares," and "to allow client annual asset allocation out of C shares without incurring fees." CX-32 at 1, 3. The reason for customer C.G.'s switches was also reported as "to allow client annual asset allocation out of C shares without incurring fees." CX-32 at 3. Similarly, the reason given for switches by customers D.L, E.P., M.R., and Mr. J.T., was recorded in the switch log as "to allow annual asset allocation without incurring fees." CX-32 at 2, 4.

These stated reasons were false. As discussed above, each of these switches was from Class B shares to Class C shares; in each instance, the client incurred fees; and in each instance, the switch was prompted by concerns about declines in the market and the balance in the client's account, and not for the purpose of the annual asset allocation. By providing false information for the switch log, Respondent violated NASD Conduct Rules 3110 and 2110.

2. Respondent Caused Order Tickets to Be Inaccurate in Violation of NASD Conduct Rules 3110 and 2110

In 2001 and 2002, registered representatives at Respondent's firm were required to fill out an order ticket when they received orders. The order tickets were used in executing trades, and were reviewed daily by the branch manager. Tr. 822 – 823. The order tickets required the registered representatives to report whether a trade was solicited or unsolicited. Tr. 824. If the ticket was mismarked, the registered representative was responsible for reporting the error to the firm. Tr. 825 – 826.

Enforcement contends that Respondent mismarked, or caused to be mismarked, order tickets for 31 transactions. Solicited orders were marked as unsolicited for customers R.J., E.P.,

and Mr. J.T. CX-633. In fact, the transactions were solicited. J.T. testified, "[Respondent] wanted to sell the B shares because they weren't performing and wanted to get into something else." Tr. 83 – 84. E.P. testified, "[Respondent] contacted me, and he said that if I don't get into the mutual funds, I wouldn't be able to recoup any of the losses if the market came back … It wasn't my idea [to go back into mutual fund C shares], no. It was his choice on where to put it." Tr. 691 – 692. Respondent also solicited the transaction with respect to customer R.J. "He said that I need to get back in the market because I'm drawing money out every month and my account's going down and it was a good time to get back into the market." Tr. 618. Similarly, R.J. was asked at the hearing, "Whose idea was it to buy these, sir?" He responded simply, "Wilson's." Tr. 619.

The Hearing Panel finds that Respondent violated NASD Conduct Rules 3110 and 2110 by mismarking order tickets as unsolicited, when the orders were, in fact, solicited.

IV. Sanctions

The Department of Enforcement recommends a bar in all capacities. Enforcement recommends the determination of the appropriate sanctions for all violations collectively, because "the interrelated nature of Wilson's conduct dictates that his misconduct be analyzed, for sanctions purposes, as a comprehensive failure on his part to abide by the most fundamental of industry rules, that of fair dealing with his customers." Department of Enforcement's Post-Hearing Brief, at 25. While the violations are interrelated, the Hearing Panel has considered the violations separately.

A. Misrepresentations

For misrepresentations, the FINRA Sanction Guidelines recommend a fine of $2,500 to $50,000 for negligent misconduct and a suspension of up to 30 days. For intentional or reckless misconduct, the Guidelines recommend a fine of $10,000 to $100,000, a suspension of ten

business days to two years, or a bar in egregious cases. The Principal Considerations are those in the Introductory Section, applicable to all violations.[36]

Several Principal Considerations are applicable. Respondent has not accepted responsibility for his actions. Principal Consideration #2. He has not admitted to even a possibility that his customers could have been misled into believing they could retire and not take a new job with the peace of mind of knowing that their financial future was assured.

Respondent made the same misrepresentations repeatedly, both in his brochures and verbally. Principal Consideration #8. Respondent has been making these representations for an extended period of time. His misrepresentations to the customers who testified spanned a period of about 4 years. Principal Consideration #9.

Respondent's misrepresentations resulted in injury to his customers. Principal Consideration #11. The customers considered Respondent's representations in many important decisions. Some relied on his representations in deciding whether to retire; some in how they could afford to live in retirement; and some in whether to take a job to supplement their retirement savings. See, e.g., Tr. 147 – 148, 278 – 279, 663, 953, 1200 – 1201.

Respondent's misconduct was intentional. Principal Consideration #13. In 17 years of counseling GTE retirees, he clearly knew what they wanted to hear. Promises of a carefree early retirement were calculated to attract new clients. He also clearly knew that his representations were likely to mislead his clients into unwarranted confidence, if not certainty, that they would achieve the returns that Respondent predicted.

[36] FINRA Sanction Guidelines at 93 (2007), available at http://www.finra.org/sanctionguidelines.

Respondent's misrepresentations resulted in monetary gain. Principal Consideration #17. In fact, his entire livelihood was built on attracting business from GTE retirees. He made substantial commissions from sales to the retirees who testified, and hundreds more.

The level of sophistication of the injured or affected customer is an important consideration in this case. Principal Consideration #19. As Respondent well knew, the GTE retirees were very unsophisticated investors. The sole investing experience for almost all was participating in their company's 401(k) plans and ESOPs. It was evident at the hearing that, even after as many as 11 years of investing since retirement and having been part of the way through an arbitration, several struggled to respond to basic questions about their investments, such as what a mutual fund was, what the share classes were or why different classes mattered, and what they had invested in. Respondent took advantage of this lack of sophistication to induce his clients to entrust their retirement funds, typically almost all of their assets other than their homes, to him.

The Hearing Panel finds that a bar is the appropriate sanction for Respondent's fraudulent misrepresentations.

B. Recommending Unsuitable Trades

For recommending unsuitable transactions, the Sanction Guidelines recommend a fine of $2,500 to $75,000, a suspension of ten business days to one year, or a longer suspension or a bar in egregious cases.[37] The Principal Considerations are those in the Introductory Section.

While Respondent admits that he recommended all of the switching transactions, he has not acknowledged that the transactions might have been improper. Principal Consideration #2. He blames the switching on panic by his clients, an unforeseeable market decline, and poor performance by the managers of the funds he had selected. His explanations for switching fund

[37] Sanction Guidelines at 99.

families, and switching from B shares to C shares, were disingenuous attempts to rationalize transactions that cost his clients substantial sums.

Respondent engaged in a pattern of switches. Principal Consideration #8. He switched all the funds for 12 customers. The switching extended over a substantial period, from March 2001 until the end of May 2002. CX-608. Principal Consideration #9. The mismarking of the trade tickets and false information provided for the switch logs served to conceal the character of his conduct from his firm. Principal Consideration #10.

Respondent's clients were injured by the switches. Principal Consideration #11. The direct injury was the CDSCs that they paid as a result of the switches. They were also injured because they lost the accumulated time they had all been invested in their B shares toward entitlement to switch to lower-cost A shares. During the period they were invested in C shares, they were injured by having to pay the higher fees typically charged to investors in C shares.

Respondent's misconduct was intentional. Principal Consideration #13. He clearly knew he was switching customers from B shares to C shares, and that they could have avoided the CDSCs by staying in B shares within the same fund families. Respondent benefited from the switches, receiving commissions of $36,516.14 for the switch transactions. CX-602; CX-608; Tr. 1323 – 1324. Principal Consideration #17. Respondent effected a large number of switches. Principal Consideration #18.

The level of sophistication of the injured or affected customers is also an aggravating factor for the switches. Principal Consideration #19. Respondent's customers had to trust his recommendations to switch. Even those who understood that there was a fee involved in switching did not understand that they could avoid the fee by staying in the same fund family,

and lacked the financial experience and sophistication to understand whether it was in their best interest to incur a fee.

The Hearing Panel finds that a bar is the appropriate sanction for Respondent's unsuitable recommendations to his clients to engage in mutual fund switching, and for effecting those switches.

C. Unauthorized Trading

For unauthorized trading, the Sanction Guidelines recommend consideration of a fine of $5,000 to $75,000, a suspension of ten business days to one year, and in egregious cases, a suspension of up to two years or a bar.[38] In addition to the Principal Considerations in the Introductory Section, the Principal Considerations are whether respondent misunderstood his authority or the terms of the customer's orders, and whether the unauthorized trading was egregious.[39]

Respondent could not have misunderstood his authority or the terms of the three customers' orders because he had no authority to make the switch transactions, and had no direction from his customers. The unauthorized trading was egregious. There were numerous unauthorized switch transactions for each of the three customers involved. The unauthorized

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[38] Sanction Guidelines at 103.

[39] The Sanction Guidelines note that the NAC has identified in its decisions the following categories of egregious unauthorized trading:

> 1) quantitatively egregious unauthorized trading, i.e., unauthorized trading that is egregious because of the sheer number of unauthorized trades executed; 2) unauthorized trading accompanied by aggravating factors, such as, efforts to conceal the unauthorized trading, attempts to evade regulatory investigative efforts, customer loss, or a history of similar misconduct (this list is illustrative, not exhaustive); and 3) qualitatively egregious unauthorized trading. Two factors are relevant to a determination as to whether unauthorized trading is qualitatively egregious: 1) the strength of the evidence, and 2) the respondent's motives; i.e., whether the respondent acted in bad faith or as a result of a reasonable misunderstanding. See, e.g., *In re Daniel S. Hellen*, Complaint No. C3A970031 (N.A.C. June 15, 1999).

Sanction Guidelines at 103, fn.2.

trading caused customer harm and benefited Respondent, as discussed above. The Hearing Panel imposes a bar for engaging in unauthorized trading.

D. Discretionary Trading Without Written Authorization

For discretionary trading without written authorization, the Sanction Guidelines recommend a fine of $2,500 to $10,000, and consideration of a suspension of ten to 30 business days in egregious cases.[40] The Principal Considerations are whether the customer's grant of discretion was express or implied, and whether the firm's policies and/or procedures prohibited discretionary trading and/or whether the firm prohibited the respondent from exercising discretion in customer accounts.

Both Principal Considerations are aggravating factors. There were neither express nor implied grants of authority from Respondent's customers to choose which funds to sell to make their monthly distributions. Respondent had no express or implied authority from his firm to exercise discretion in the accounts, and his firm prohibited the exercise of discretion in IRA accounts.

The Hearing Panel would impose a fine of $10,000 and a 30-day suspension, the maximum sanctions recommended in the Sanction Guidelines, for this violation. In light of the imposition of bars for the first three causes of action, however, no sanction is imposed. The Hearing Panel considered the exercise of discretion as an aggravating factor with respect to the other violations, because it represented a lack of regard for FINRA's rules, and a disdain for the rights of his customers to make their own investment decisions.

E. Recordkeeping

For recordkeeping violations, the Sanction Guidelines recommend a fine of $1,000 to $10,000, a suspension of up to 30 business days, or a longer suspension or a bar in egregious

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[40] Sanction Guidelines at 90.

cases.[41] The Principal Considerations are the nature and materiality of the inaccurate or missing information.

The Hearing Panel finds that the recordkeeping violations were egregious. The false information concerning the reasons for the mutual switches deprived Respondent's firm of the opportunity to assess whether the switches were suitable for Respondent's customers and consistent with their investment objectives. Similarly, reporting the switches as unsolicited would likely lessen the firm's scrutiny of the transactions. The Hearing Panel considered the recordkeeping violations in determining the sanction for the unsuitable transactions, and in light of the bar for that violation, does not impose a separate sanction for the recordkeeping violations.

F. Restitution

The Hearing Panel does not order restitution. Respondent entered into settlement agreements with each of the customer witnesses in connection with an arbitration of claims similar to those alleged in the Amended Complaint. CX-1; CX-604; Tr. 314 – 315, 624, 693, 1099. The NAC has held that where the customers have settled their claims with the respondent and released their claims against him, FINRA will not order restitution unless the settlement was procured by fraud.[42] Here, the customers were represented by counsel in the arbitration, and there is no evidence that the settlements were procured by fraud.

V. Conclusion

Respondent Stephen W. Wilson is barred for making fraudulent misrepresentations in violation of Section 10(b) of the Securities Exchange Act of 1934, SEC Rule 10b-5, and NASD Conduct Rules 2120 and 2110. Respondent is also barred for recommending unsuitable mutual fund switch transactions in violation of NASD Conduct Rules 2310 and 2110, and IM-2310-2,

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[41] Sanction Guidelines at 30.

[42] *Dep't of Enforcement v. Kaweske*, No. C07040042, 2007 NASD Discip. LEXIS 5, at *54 – *55 (N.A.C. Feb. 12, 2007).

and for engaging in unauthorized trading in violation of NASD Conduct Rule 2110 and IM-2310-2. In light of the bars, the Hearing Panel does not impose a separate sanction for engaging in discretionary trading without written authorization in violation of NASD Conduct Rules 2510(b) and 2110, or for causing the books and records of his firm to be inaccurate in violation of NASD Conduct Rules 3110 and 2110.

If this decision becomes FINRA's final action in this matter, the bars shall be effective immediately. In addition, Respondent shall pay costs in the amount of $13,465.80, which represents the cost of the hearing transcript together with a $750 administrative fee. The costs shall be payable on a date set by FINRA, but not less than 30 days after this decision becomes FINRA's final disciplinary action in this matter.[43]

HEARING PANEL

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By: Lawrence B. Bernard
Hearing Officer

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Peter Brown Dolan, Esq. (*via e-mail and first-class mail*)
Gerard F. Murphy, Esq. (*via e-mail and first-class mail*)
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Robin W. Sardegna, Esq. (*via e-mail and first-class mail*)
David R. Sonnenberg, Esq. (*via e-mail*)

[43] The Hearing Panel considered and rejected without discussion all other arguments of the parties.