

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS**

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

Respondent.

Disciplinary Proceeding
No. 2008015270701

Hearing Officer – LBB

**HEARING PANEL
DECISION**

Dated: June 9, 2011

Respondent exercised discretion in a customer's account without written authorization from the customer, in violation of NASD Conduct Rules 2510(b) and 2110. This Decision shall serve as a Cautionary Action Letter to Respondent.

Appearances

Laura Leigh Blackston, Esq., Senior Regional Counsel, and Mark J. Fernandez, Senior Regional Counsel, New Orleans, Louisiana, for the Department of Enforcement.

George C. Freeman, III, Esq., and David N. Luder, Esq., New Orleans, Louisiana, for Respondent.

DECISION

The Department of Enforcement ("Enforcement") filed the one-cause Complaint in this disciplinary proceeding on September 14, 2010, charging Respondent with exercising discretion in the account of customer J.D. without prior written authorization from the customer or acceptance of the customer's account as discretionary by his member firm, in violation of NASD Conduct Rules 2510(b) and 2110. Respondent filed his Answer on October 8, 2010, denying that he had exercised discretion in the customer's account.¹

¹ FINRA began its investigation of this matter in response to the filing of a Uniform Termination Notice for Securities Industry Registration (Form U5) by the Firm, reporting that customer J.D. had complained that Respondent had executed unauthorized transactions in his account. Tr. 34-35.

On January 4 and 5, 2011, the parties filed cross-motions for summary disposition with respect to liability. By Order of March 15, 2011, the Hearing Panel granted Enforcement's motion and denied Respondent's motion, finding that Respondent had exercised discretion in J.D.'s account with respect to the time at which transactions were executed, without receiving written authorization from the customer, in violation of NASD Rules 2510 and 2110.² A hearing on the issue of sanctions was conducted in New Orleans, Louisiana, on March 30, 2011, before a Hearing Panel composed of two current members of the District 5 Committee and a Hearing Officer.

I. Summary of Facts³

Respondent first entered the securities industry in 1985 as a registered representative. At all times relevant to this matter, Respondent was registered as a general securities representative with [] ("the Firm"). Respondent ended his employment at the Firm in August 2008, and is currently registered with another FINRA member firm.

Respondent became J.D.'s financial advisor in the fall of 2005. J.D. was a doctor and a missionary. In anticipation of J.D.'s departure for a six-month missionary trip to Africa starting in October 2007, when he was 85 years old, J.D. met with Respondent to discuss the state of his

² 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). The Hearing Panel's Order granting Enforcement's motion for summary disposition and denying Respondent's motion refers to and relies on the NASD Conduct Rules that were in effect at the time of Respondent's alleged violation.

³ Except for footnotes 4-6 and the last paragraph, this factual summary is taken directly from the Hearing Panel's summary disposition Order, with the citations to the record evidence considered in that Order omitted. References to the exhibits provided by Enforcement at the hearing are designated as "CX-___." References to the exhibits provided by Respondent at the hearing are designated as "RX-___." References to the hearing transcript are designated as "Tr. ___."

investments.⁴ Among the topics discussed was J.D.'s fixed annuity with AIG. After discussing various factors related to the investment, J.D. instructed Respondent to liquidate the annuity and invest the proceeds in mutual funds.⁵

J.D.'s account with the Firm was not discretionary. Because Respondent would not be able to communicate with J.D. while he was on his missionary trip, J.D. instructed Respondent to purchase five mutual funds as soon as Respondent learned that the proceeds from the liquidation of the annuity had arrived in J.D.'s account. J.D. instructed Respondent on the specific amounts to invest in Class B shares of each of the five mutual funds: \$50,000 in shares of Income Fund of America; \$50,000 in shares of TransAmerica Asset IDEX Allocation Moderate Portfolio; \$50,000 in shares of Evergreen Equity Trust Asset Allocation Fund; \$25,000 in shares of Putnam Asset Allocation Fund Balanced Portfolio; and \$25,000 in shares of ING Diversified International. All five funds were open-end mutual funds, priced at the end of each trading day. J.D.'s instructions were oral; Respondent did not receive written discretionary authority from J.D.

The proceeds from the liquidation of the AIG annuity arrived in J.D.'s account on November 7, 2007. Respondent was on vacation from November 4 to November 12, and did not learn of the arrival of the money until he returned from vacation.⁶ On the day Respondent returned from vacation, he submitted orders for the purchase of the designated mutual funds in the pre-determined amounts. Respondent bought the five mutual funds in the pre-determined amounts for J.D.'s account on November 13, 2007.

⁴ J.D. died in November 2009. Tr. 39.

⁵ At the hearing, Respondent explained that it was advantageous to delay the submission of the surrender forms to AIG until after J.D. was to leave for Africa, to avoid incurring surrender fees. Tr. 76, 99, 116.

⁶ Respondent explained at the hearing that in his experience, funds from the liquidation of an annuity are typically received about a month after submission of the forms to the insurer. Thus, he had not expected the funds to arrive while he was on vacation. Tr. 95.

Respondent met with J.D. in May 2008, soon after J.D. returned from Africa, and reminded J.D. that he had a tax liability as a result of the sale of the annuities, and that cash had been set aside from the liquidation of the annuities to provide for the tax liability. Tr. 104-105. Respondent subsequently met with J.D. and his accountant for the signing and filing of J.D.'s amended tax return. Tr. 109. After payment of the tax liability, about \$20,000 in cash remained, which J.D. directed Respondent to invest in one of the mutual funds in which the proceeds of the liquidation of the annuity had been invested. Tr. 109, 113-114. Respondent received \$3,040 in commissions for the November 2007 purchase of the mutual funds for J.D.'s account. Tr. 54.

II. Conclusions of Law From the Order on Summary Disposition: Respondent Violated NASD Conduct Rule 2510 When He Exercised Discretion in J.D.'s Account

In ruling on the motions for summary disposition, the Hearing Panel stated the following conclusions of law:

NASD Conduct Rule 2510(b) provides:

No member or registered representative shall exercise any discretionary power in a customer's account unless such customer has given prior written authorization to a stated individual or individuals and the account has been accepted by the member, as evidenced in writing by the member or the partner, officer or manager, duly designated by the member, in accordance with Rule 3010.

Rule 2510(d)(1) provides an exception for "discretion as to the price at which or the time when an order given by a customer for the purchase or sale of a definite amount of a specified security shall be executed...." Under the exception, time and price discretion is valid only until the end of the business day on which the customer grants such discretion, absent a specific, written contrary indication signed and dated by the customer. FINRA has explained that before the Rule was changed to limit oral grants of discretion to the business day on which discretion was granted, there were problems when a representative was granted such authority but did not exercise it for several weeks, leading to claims of unauthorized trading by customers who may

have forgotten that they granted discretion or assumed it was not valid for such an extended period of time.⁷

J.D. granted discretion to Respondent orally, which he exercised. The oral instruction to purchase the mutual funds when Respondent became aware that the funds were in J.D.'s account was a grant of considerable discretion. Respondent could choose the time at which to inquire as to the status of the deposit of funds, and did so. He admits that he did not learn of the deposit of funds until almost a week after they were deposited because he was on vacation, choosing not to inquire while he was out of the office and not to leave instructions with his firm to execute the transactions when the funds arrived. Upon his return, Respondent also had the discretion not to inquire about the funds immediately. He might have chosen not to inquire for many reasons – the press of other business or a belief that the market was about to decline, for example – and still comply with J.D.'s instructions. This discretion could easily lead to a misunderstanding between the client and Respondent as to when the trades should have been executed, one of the problems that NASD Conduct Rule 2510 is intended to avoid.

The Hearing Panel finds that Respondent exercised discretion concerning the timing of investments for J.D.'s account without written authority, thereby violating NASD Conduct Rules 2510(b) and 2110.⁸

III. Sanctions

For exercising discretion without a customer's written authorization, the FINRA Sanction Guidelines ("Guidelines") recommend a monetary sanction of \$2,500 to \$10,000, which may be increased by the amount of the respondent's financial benefit. In egregious cases, adjudicators

⁷ Improving Examination Results (May 2008) (*available at* www.finra.org/Industry/Regulation/Guidance/ImprovingExaminationResults/p038526).

⁸ A violation of Rule 2510 is also a violation of Rule 2110. *Dep't of Enforcement v. Merhi*, No. E072004044201, 2007 NASD Discip. LEXIS 9, at *33 n.20 (N.A.C. Feb. 16, 2007); *see also*, *Kirlin Securities*, Exchange Act Rel. No. 61135, 2009 SEC LEXIS 4168, at *59–60, n.81 (Dec. 10, 2009).

This Decision has been published by FINRA's Office of Hearing Officers and should be cited as OHO Redacted Decision 2008015270701.

may consider suspending the respondent in any or all capacities for 10 to 30 business days. The principal considerations are whether the customer's grant of discretion was express or implied, and whether the firm's policies and procedures prohibited discretionary trading, either generally or by the respondent.⁹

The Guidelines provide that, in appropriate cases, an adjudicator may impose lesser sanctions, or no sanction at all:

The recommended ranges in these guidelines are not absolute. The guidelines suggest, but do not mandate, the range and types of sanctions to be applied. Depending on the facts and circumstances of a case, Adjudicators may determine that no remedial purpose is served by imposing a sanction within the range recommended in the applicable guideline; i.e., that a sanction below the recommended range, or no sanction at all, is appropriate.¹⁰

The Hearing Panel finds that it is appropriate, under the facts and circumstances of this case, to issue a Cautionary Action Letter to Respondent. In reaching this decision, the Hearing Panel finds that there are no aggravating factors, and that no remedial purpose would be served by imposing either a suspension or a fine.

The principal considerations do not support the imposition of a suspension or fine. The customer expressly granted discretion to Respondent, but the grant of discretion was oral. In addition, the grant of discretion was circumscribed. The customer directed Respondent to invest specific amounts in each of five mutual funds. Respondent's discretion was limited to the determination of the time to inquire as to whether the funds had been received, and therefore the time at which to invest.

Other considerations also support a sanction less than the recommended sanctions. Respondent's violation was neither reckless nor intentional. Respondent believed that his

⁹ *FINRA Sanction Guidelines* at 87 (2011).

¹⁰ *Guidelines* at 3.

conduct was proper and did not constitute an exercise of discretion.¹¹ Although he failed to recognize that he had discretion as to the timing of the purchase, he did not intend to violate FINRA's Rules. Respondent did not attempt to use the discretion he had to try to time the market, but executed the trades immediately upon learning that his firm had received the funds, when he returned from vacation. The violation involved a single set of transactions that occurred on one day, and not a pattern or continuing course of conduct.¹² In addition, the circumstances were highly unusual. Respondent's client asked him to execute transactions that could not be completed until the client was in a remote part of Africa, where he would not be available to communicate with Respondent for six months.¹³

An important factor in the Hearing Panel's sanctions determination is Respondent's remorse over this incident. Both in his words and his demeanor, Respondent's remorse was evident. Respondent testified that he was "very sorry this happened," that he has "learned some very valuable lessons," and that he will do his best to be sure this error never happens again. Tr. 132-133. The Hearing Panel found that both the content of Respondent's testimony and the emotion he displayed when testifying to the effect of this proceeding and his intention to comply

¹¹ Tr. 103, 125-127. See *Guidelines* at 7, Principal Consideration No. 13 ("Whether the respondent's misconduct was the result of an intentional act, recklessness or negligence.").

¹² See *Guidelines* at 6, Principal Consideration No. 8 ("Whether the respondent engaged in numerous acts and/or a pattern of misconduct") and Principal Consideration No. 9. ("Whether the respondent engaged in the misconduct over an extended period of time.").

¹³ J.D. would be in a remote area of Cameroon, accompanied by a former Marine with survivalist training, and would not be able to communicate with Respondent during his missionary trip. Tr. 119-120.

with FINRA's Rules, especially in obtaining written authority for future transactions, were genuine and credible.¹⁴

For the foregoing reasons, the Hearing Panel finds that a Cautionary Action Letter is sufficiently remedial. This Decision shall serve as a Cautionary Action Letter.

IV. Conclusion

Respondent exercised discretion in a customer's account without written authorization from the customer, in violation of NASD Conduct Rules 2510(b) and 2110. This Decision shall serve as a Cautionary Action Letter to Respondent. Respondent is ordered to pay costs in the amount of \$1,972.90, which includes an administrative fee of \$750 plus the cost of the hearing transcript.¹⁵

HEARING PANEL

Lawrence B. Bernard
Hearing Officer

Copies to: Respondent (*via overnight courier and first-class mail*)
George C. Freeman, III, Esq. (*via overnight courier, electronic and first-class mail*)
David N. Luder, Esq. (*via electronic and first-class mail*)
Laura Leigh Blackston, Esq. (*via electronic and first-class mail*)
Mark J. Fernandez, Esq. (*via electronic mail*)
Mark P. Dauer, Esq. (*via electronic mail*)
David R. Sonnenberg, Esq. (*via electronic mail*)

¹⁴ Enforcement argued that Respondent attempted to blame another representative for the disciplinary issue, citing Respondent's testimony in his on-the-record interview that J.D.'s complaint was initiated by another broker. Department of Enforcement's Pre-Hearing Brief, citing CX-1 at 65-66. In context, it is clear that Respondent was discussing the allegation by J.D. that Respondent had engaged in unauthorized trading, a violation that was not charged in the Complaint. The FINRA examiner found that the allegation of unauthorized trading was not well supported and that there was evidence inconsistent with the allegation that the trades were unauthorized. She testified that J.D. was confused about what had occurred. Documentary evidence suggests that a competing broker had a role in J.D.'s allegation that Respondent's purchase of the mutual funds for J.D.'s account was unauthorized. *See* Tr. 65-66, 79, 88-89; CX-3 at 2.

¹⁵ The Hearing Panel has considered all of the arguments of the parties. They are rejected or sustained to the extent they are inconsistent or in accord with the views expressed herein.