

N.A.S.D. REGULATION AWARD

NATIONAL ASSOCIATION OF SECURITIES DEALERS REGULATION, INC.

In the Matter of the Arbitration Between

Name of Claimant

Bruce E. Babula c/f Lauren K. Babula

96-03301

Name of Respondents

Janney Montgomery Scott Inc.
William J. Pearce

CASE SUMMARY

In a case filed with National Association of Securities Dealers Regulation Inc. on August 1, 1996, claimant Bruce E. Babula c/f Lauren Babula ("claimant") who appeared Pro Se, alleged that respondents Janney Montgomery Scott, Inc. ("JMS") and William Pearce ("Pearce") sold him a product fraudulently or in error. Claimant further alleged that in July 1993, Pearce who was well aware of his custodial goals and risk tolerance, advised him to purchase mortgage backed securities which he stated were from "tranches", which would return the principal by 1997. Claimant asserted that based on Pearce's continued recommendation and reassurance, he made a purchase. Claimant further asserted that he would not have opted to switch investments if he had not been assured of the safe and timely return of principal.

Claimant also asserted that as time passed he noted that the principal return rate was at marked variance with what had been promised. Claimant contended that in January of 1996, he had a series of fruitless telephone conversations with Pearce. Claimant further contended that Pearce admitted that JMS monthly statements overvalued the true market value of the securities. Claimant also contended that a letter he received from JMS stated that "at the time these securities were stated to have a three to five year average life span and that two of the three were immediate paying bonds." Claimant alleged that consultation in 1996 with another investment firm yielded the information that these were in fact high-risk tranches and were projected as eight to twelve year bonds as of 1996.

Respondents JMS and Pearce (collectively referred to as "respondents") through their representative and counsel Paula Shaffner of the law firm Saul, Ewing, Remick & Saul, located in Philadelphia, Pennsylvania, maintained that claimant's claim relates to Collateralized Mortgage Obligations ("CMOs"), which he had purchased for his own account and four custodial accounts. Respondents further maintained that in spring of 1993, Pearce was assigned claimant's account when their old registered representative left JMS. Respondents also maintained that once Pearce was assigned the account he spoke with claimant to gather information about him, his wife and children, their investment objectives, financial situation and risk tolerance. Respondents contended that claimant spoke with Pearce regularly about his investments which included the Fund. Respondents further contended that claimant was concerned about the effect of interest rates on the value of those investments. Respondents also contended that claimant understood quite clearly the effect of interest rates on the value of securities and routinely checked with Pearce to inquire what the "dollar cost" was and where interest rates might be going. Respondents further contended that claimant was instrumental in all decisions regarding the sale and purchase of any security. Respondents also contended that the concept of the CMOs was raised as a method for investing the money

that would otherwise earn a lower rate of interest in the money market account. Respondents maintained that at the time the investment was made, the CMOs were stated to have a three to five average life, two of which were immediate paying bonds. Respondents further maintained that Pearce thoroughly explained the mortgaged-backed securities to claimant, specifically, the pricing assumptions, the interest rate and the effect of prepayment of the mortgage loans as discussed in detail. Respondents also maintained that Pearce discussed prepayments of mortgage loans and how they are measured relative to a prepayment standard or model and described the Public Securities Association standard prepayment model ("PSA"). Respondents contended that at the time the CMOs were purchased, it was an appropriate investment for claimant's accounts.

Respondents further contended that the CMOs were purchased in claimant's accounts on three different dates and that claimant has not lost money on any of these investments. Respondents also contended that the investments had paid interest on a monthly basis and two of the CMOs paid principal for almost two years. Respondents maintained that at this time, two of the CMOs stopped paying principal and the average life of the bonds were extended. Respondents further maintained that these changes occurred as a result of a decrease in the PSA speed, which changed the maturities of the CMOs. Respondents also maintained that claimant continues to receive interest on the investments, and while principal is not currently being prepaid on some of the CMOs, the distribution of principal and interest is guaranteed by government-backed agencies. Respondents contended that no misrepresentation was made to claimant at any time. Respondents further contended that his case involves simply the fact that the principal will not be repaid in the time period that claimant originally expected it to be.

RELIEF REQUESTED

Claimant Bruce Babula c/f Lauren Babula requested: (1) that on December 31, 1996, JMS purchase from him without fee enough bonds at par value to reduce the factor outstanding to .67; (2) that on December 31, 1997, JMS purchase enough bonds at par value to reduce the factor outstanding to .33; (3) that on December 31, 1998, JMS purchase all outstanding bonds at par; (4) if JMS desires to purchase all outstanding bonds at par immediately that would be acceptable to him; (5) plus filing costs and \$750.00 as compensation for expenditure of time and lost financial opportunity.

Respondents JMS and Pearce requested that the claims of claimant be dismissed in their entirety.

AWARD

Pursuant to Rule 10302 of the Code of Arbitration Procedure, a single Public Arbitrator, William Landers, Esq. was selected to review the matter in controversy between the parties set forth in Submissions to Arbitration signed by claimant on July 30, 1996, by respondents JMS on September 24, 1996 and Pearce on September 23, 1996 as required by Rules 10301 and 10302.

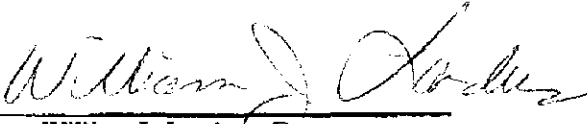
And, the Arbitrator, having considered the proof of the parties, had decided and determined in full and final resolution of the issues submitted for determination as follows:

1. The claims of Bruce Babula against JMS and Pearce are dismissed in their entirety.
2. The \$50.00 filing fee previously deposited by claimant shall be retained by NASD Regulation, Inc. Respondents JMS and Pearce be and hereby are jointly and severally liable and shall pay claimant the sum of \$50.00 as reimbursement of the filing fee.
3. All other relief requests are denied.

Page Three
Award 96-03301

AFFIRMATION

I, **William Landers, Esq.**, do hereby affirm upon my oath as arbitrator that I am individual described herein who executed this instrument, which is my oath and award.



William J. Landers, Esq.

Date of Decision:

May 20, 1997